CANADIAN PACIFIC RAILWAY LTD/CN
Form 10-Q
April 19, 2018

0false--12-31Q120182018-03-3110-Q0000016875143074798YesLarge Accelerated FilerCANADIAN PACIFIC RAILWAY LTD/CNCP 0000016875 2018-01-01 2018-03-31 0000016875 2018-04-16 0000016875 2017-01-01 2017-03-31 0000016875 2017-12-31 0000016875 2018-03-31 0000016875 2017-03-31 0000016875 2016-12-31 0000016875 us-gaap:RetainedEarningsMember 2017-01-01 2017-03-31 0000016875 us-gaap:RetainedEarningsMember 2018-01-01 2018-03-31 0000016875 us-gaap:CommonStockMember 2018-01-01 2018-03-31 0000016875 us-gaap:AdditionalPaidInCapitalMember 2018-01-01 2018-03-31 0000016875 us-gaap:AdditionalPaidInCapitalMember 2018-03-31 0000016875 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2018-01-01 2018-03-31 0000016875 us-gaap:AdditionalPaidInCapitalMember 2017-01-01 2017-03-31 0000016875 us-gaap:CommonStockMember 2017-03-31 0000016875 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2017-01-01 2017-03-31 0000016875 us-gaap:CommonStockMember 2016-12-31 0000016875 us-gaap:CommonStockMember 2017-01-01 2017-03-31 0000016875 us-gaap:CommonStockMember 2017-12-31 0000016875 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2017-12-31 0000016875 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2018-03-31 0000016875 us-gaap:RetainedEarningsMember 2017-03-31 0000016875 us-gaap:AdditionalPaidInCapitalMember 2017-03-31 0000016875 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2017-03-31 0000016875 us-gaap:AccumulatedOtherComprehensiveIncomeMember 2016-12-31 0000016875 us-gaap:AdditionalPaidInCapitalMember 2017-12-31 0000016875 us-gaap:CommonStockMember 2018-03-31 0000016875 us-gaap:RetainedEarningsMember 2018-03-31 0000016875 us-gaap:AdditionalPaidInCapitalMember 2016-12-31 0000016875 us-gaap:RetainedEarningsMember 2017-12-31 0000016875 us-gaap:RetainedEarningsMember 2016-12-31 0000016875 cp:AccountingStandardsUpdate201707Member 2017-01-01 2017-03-31 0000016875 cp:FreightMember cp:MetalsMineralsandConsumerProductsRevenueMember 2017-01-01 2017-03-31 0000016875 cp:FreightMember cp:GrainRevenueMember 2017-01-01 2017-03-31 0000016875 cp:FreightMember 2017-01-01 2017-03-31 0000016875 cp:NonFreightMember 2017-01-01 2017-03-31 0000016875 cp:FreightMember cp:EnergyChemicalsandPlasticRevenueMember 2017-01-01 2017-03-31 0000016875 cp:FreightMember cp:CoalRevenueMember 2017-01-01 2017-03-31 0000016875 cp:FreightMember cp:AutomotiveMember 2017-01-01 2017-03-31 0000016875 cp:FreightMember cp:ForestProductsRevenueMember 2017-01-01 2017-03-31 0000016875 cp:FreightMember 2018-01-01 2018-03-31 0000016875 cp:FreightMember cp:IntermodalMember 2017-01-01 2017-03-31 0000016875 cp:FreightMember cp:ForestProductsRevenueMember 2018-01-01 2018-03-31 0000016875 cp:NonFreightMember 2018-01-01 2018-03-31 0000016875 cp:FreightMember cp:IntermodalMember 2018-01-01 2018-03-31 0000016875 cp:FreightMember cp:PotashRevenueMember 2018-01-01 2018-03-31 0000016875 cp:FreightMember cp:PotashRevenueMember 2017-01-01 2017-03-31 0000016875 cp:FreightMember cp:MetalsMineralsandConsumerProductsRevenueMember 2018-01-01 2018-03-31 0000016875 cp:FreightMember cp:AutomotiveMember 2018-01-01 2018-03-31 0000016875 cp:FreightMember cp:GrainRevenueMember 2018-01-01 2018-03-31 0000016875 cp:FreightMember cp:FertilizerandSulphurRevenueMember 2018-01-01 2018-03-31 0000016875 cp:FreightMember cp:FertilizerandSulphurRevenueMember 2017-01-01 2017-03-31 0000016875 cp:FreightMember cp:EnergyChemicalsandPlasticRevenueMember 2018-01-01 2018-03-31 0000016875 cp:FreightMember cp:CoalRevenueMember 2018-01-01 2018-03-31 0000016875 us-gaap:AccumulatedTranslationAdjustmentMember 2018-01-01 2018-03-31 0000016875 us-gaap:AccumulatedDefinedBenefitPlansAdjustmentMember 2017-01-01 2017-03-31 0000016875 us-gaap:AccumulatedNetGainLossFromDesignatedOrQualifyingCashFlowHedgesMember 2017-12-31 0000016875 us-gaap:AccumulatedNetGainLossFromDesignatedOrQualifyingCashFlowHedgesMember 2018-01-01 2018-03-31 0000016875 us-gaap:AccumulatedDefinedBenefitPlansAdjustmentMember 2018-03-31 0000016875 us-gaap:AccumulatedNetGainLossFromDesignatedOrQualifyingCashFlowHedgesMember 2017-01-01 2017-03-31 0000016875 us-gaap:AccumulatedDefinedBenefitPlansAdjustmentMember 2018-01-01 2018-03-31 0000016875 us-gaap:AccumulatedDefinedBenefitPlansAdjustmentMember 2017-03-31 0000016875 us-gaap:AccumulatedDefinedBenefitPlansAdjustmentMember 2017-12-31 0000016875 us-gaap:AccumulatedDefinedBenefitPlansAdjustmentMember 2016-12-31 0000016875 us-gaap:AccumulatedNetGainLossFromDesignatedOrQualifyingCashFlowHedgesMember 2017-03-31 0000016875 us-gaap:AccumulatedTranslationAdjustmentMember 2017-01-01 2017-03-31 0000016875 us-gaap:AccumulatedTranslationAdjustmentMember 2018-03-31 0000016875 us-gaap:AccumulatedTranslationAdjustmentMember 2016-12-31 0000016875 us-gaap:AccumulatedTranslationAdjustmentMember 2017-12-31 0000016875 us-gaap:AccumulatedTranslationAdjustmentMember 2017-03-31 0000016875 us-gaap:AccumulatedNetGainLossFromDesignatedOrQualifyingCashFlowHedgesMember 2018-03-31 0000016875 us-gaap:AccumulatedNetGainLossFromDesignatedOrQualifyingCashFlowHedgesMember 2016-12-31 0000016875 us-gaap:ReclassificationOutOfAccumulatedOtherComprehensiveIncomeMember 2017-01-01 2017-03-31 0000016875 us-gaap:ReclassificationOutOfAccumulatedOtherComprehensiveIncomeMember 2018-01-01 2018-03-31 0000016875 us-gaap:ChiefExecutiveOfficerMember 2017-01-01 2017-03-31 0000016875 us-gaap:EmployeeStockOptionMember 2017-01-01 2017-03-31 0000016875 us-gaap:EmployeeStockOptionMember 2018-01-01 2018-03-31 0000016875 cp:CurrentNormalCourseIssuerBidNCIBMember 2018-01-01 2018-03-31 0000016875 cp:CurrentNormalCourseIssuerBidNCIBMember 2017-05-15 2018-03-31 0000016875 us-gaap:MaximumMember cp:CurrentNormalCourseIssuerBidNCIBMember 2017-05-10 0000016875 cp:NormalCourseIssuerBidNCIBMember 2017-01-01 2017-03-31 0000016875 us-gaap:InterestRateSwapMember us-gaap:InterestExpenseMember 2017-01-01 2017-03-31 0000016875 us-gaap:InterestRateSwapMember us-gaap:InterestExpenseMember 2018-01-01 2018-03-31 0000016875 us-gaap:InterestRateSwapMember 2018-01-01 2018-03-31 0000016875 us-gaap:InterestRateSwapMember 2018-03-31 0000016875 us-gaap:InterestRateSwapMember 2017-12-31 0000016875 us-gaap:AccountsPayableAndAccruedLiabilitiesMember us-gaap:InterestRateSwapMember 2017-12-31 0000016875 us-gaap:NetInvestmentHedgingMember 2017-01-01 2017-03-31 0000016875 us-gaap:InterestRateSwapMember 2017-01-01 2017-03-31 0000016875 us-gaap:AccountsPayableAndAccruedLiabilitiesMember us-gaap:InterestRateSwapMember 2018-03-31 0000016875 us-gaap:NetInvestmentHedgingMember 2018-01-01 2018-03-31 0000016875 us-gaap:CarryingReportedAmountFairValueDisclosureMember 2017-12-31 0000016875 us-gaap:CarryingReportedAmountFairValueDisclosureMember 2018-03-31 0000016875 us-gaap:EmployeeStockOptionMember 2018-01-01 2018-03-31 0000016875 us-gaap:PerformanceSharesMember 2018-01-01 2018-03-31 0000016875 us-gaap:EmployeeStockOptionMember us-gaap:MaximumMember 2018-01-01 2018-03-31 0000016875 us-gaap:PerformanceSharesMember us-gaap:ChiefExecutiveOfficerMember 2017-01-01 2017-03-31 0000016875 us-gaap:PerformanceSharesMember 2017-01-01 2017-12-31 0000016875 cp:DeferredShareUnitMember 2018-01-01 2018-03-31 0000016875 cp:DeferredShareUnitMember us-gaap:ChiefExecutiveOfficerMember 2017-01-01 2017-03-31 0000016875 us-gaap:EmployeeStockOptionMember us-gaap:MinimumMember 2018-01-01 2018-03-31 0000016875 us-gaap:EmployeeStockOptionMember us-gaap:ChiefExecutiveOfficerMember 2017-01-01 2017-03-31 0000016875 us-gaap:OtherPostretirementBenefitPlansDefinedBenefitMember 2018-01-01 2018-03-31 0000016875 us-gaap:PensionPlansDefinedBenefitMember 2017-01-01 2017-03-31 0000016875 us-gaap:OtherPostretirementBenefitPlansDefinedBenefitMember 2017-01-01 2017-03-31 0000016875 us-gaap:PensionPlansDefinedBenefitMember 2018-01-01 2018-03-31 0000016875 cp:PurchasedServicesandOtherMember 2017-01-01 2017-03-31 0000016875 cp:QuebecMinisterofSustainableDevelopmentandEnvironmentMember cp:LacMeganticRailAccidentMember 2016-07-05 2016-07-05 0000016875 cp:QuebecAttorneyGeneralMember cp:LacMeganticRailAccidentMember 2017-10-10 2017-10-10 0000016875 cp:TheWDTrusteeMember cp:LacMeganticRailAccidentMember cp:LadingLossRecoveryMember 2016-04-12 2016-04-12 0000016875 cp:IrvingOilMember cp:LacMeganticRailAccidentMember 2016-04-12 2016-04-12 0000016875 cp:LacMeganticRailAccidentMember cp:ClaimedLossorDamagesDuetoDerailmentMember 2018-01-01 2018-03-31 0000016875 cp:InitialInsurerClaimantsMember cp:LacMeganticRailAccidentMember cp:SubrogatedInsuranceClaimMember 2016-07-04 2016-07-04 0000016875 cp:QuebecAttorneyGeneralMember cp:LacMeganticRailAccidentMember 2015-07-06 2015-07-06 0000016875 cp:WorldFuelEntitiesMember cp:MontrealMaineandAtlanticRailwayBankruptcyEstateMember cp:LacMeganticRailAccidentMember 2016-04-12 2016-04-12 0000016875 cp:AdditionalInsurerClaimantsMember cp:LacMeganticRailAccidentMember cp:SubrogatedInsuranceClaimMember 2016-07-11 0000016875 cp:InitialInsurerClaimantsMember cp:LacMeganticRailAccidentMember cp:SubrogatedInsuranceClaimMember 2017-12-28 2017-12-28 0000016875 cp:AdditionalInsurerClaimantsMember cp:LacMeganticRailAccidentMember cp:SubrogatedInsuranceClaimMember 2016-07-11 2016-07-11 0000016875 cp:PurchasedServicesandOtherMember 2018-01-01 2018-03-31 0000016875 cp:InitialInsurerClaimantsMember cp:LacMeganticRailAccidentMember cp:SubrogatedInsuranceClaimMember 2016-07-04 0000016875 us-gaap:ParentCompanyMember us-gaap:ReportableLegalEntitiesMember 2018-01-01 2018-03-31 0000016875 us-gaap:ConsolidationEliminationsMember 2018-01-01 2018-03-31 0000016875 us-gaap:SubsidiaryIssuerMember us-gaap:ReportableLegalEntitiesMember 2018-01-01 2018-03-31 0000016875 us-gaap:NonGuarantorSubsidiariesMember us-gaap:ReportableLegalEntitiesMember 2018-01-01 2018-03-31 0000016875 us-gaap:ConsolidationEliminationsMember 2017-01-01 2017-03-31 0000016875 us-gaap:ParentCompanyMember us-gaap:ReportableLegalEntitiesMember 2017-01-01 2017-03-31 0000016875 us-gaap:NonGuarantorSubsidiariesMember us-gaap:ReportableLegalEntitiesMember 2017-01-01 2017-03-31 0000016875 us-gaap:SubsidiaryIssuerMember us-gaap:ReportableLegalEntitiesMember 2017-01-01 2017-03-31 0000016875 us-gaap:ConsolidationEliminationsMember 2018-03-31 0000016875 us-gaap:NonGuarantorSubsidiariesMember us-gaap:ReportableLegalEntitiesMember 2018-03-31 0000016875 us-gaap:ParentCompanyMember us-gaap:ReportableLegalEntitiesMember 2018-03-31 0000016875 us-gaap:SubsidiaryIssuerMember us-gaap:ReportableLegalEntitiesMember 2018-03-31 0000016875 us-gaap:NonGuarantorSubsidiariesMember us-gaap:ReportableLegalEntitiesMember 2017-12-31 0000016875 us-gaap:SubsidiaryIssuerMember us-gaap:ReportableLegalEntitiesMember 2017-12-31 0000016875 us-gaap:ParentCompanyMember us-gaap:ReportableLegalEntitiesMember 2017-12-31 0000016875 us-gaap:ConsolidationEliminationsMember 2017-12-31 0000016875 us-gaap:ParentCompanyMember us-gaap:ReportableLegalEntitiesMember 2016-12-31 0000016875 us-gaap:NonGuarantorSubsidiariesMember us-gaap:ReportableLegalEntitiesMember 2016-12-31 0000016875 us-gaap:ParentCompanyMember us-gaap:ReportableLegalEntitiesMember 2017-03-31 0000016875 us-gaap:SubsidiaryIssuerMember us-gaap:ReportableLegalEntitiesMember 2017-03-31 0000016875 us-gaap:NonGuarantorSubsidiariesMember us-gaap:ReportableLegalEntitiesMember 2017-03-31 0000016875 us-gaap:ConsolidationEliminationsMember 2017-03-31 0000016875 us-gaap:SubsidiaryIssuerMember us-gaap:ReportableLegalEntitiesMember 2016-12-31 0000016875 us-gaap:ConsolidationEliminationsMember 2016-12-31 iso4217:CAD iso4217:CAD xbrli:shares cp:claim xbrli:pure xbrli:shares iso4217:USD

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2018

OR

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number 001-01342

Canadian Pacific Railway Limited

(Exact name of registrant as specified in its charter)

Canada	**98-0355078**
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
7550 Ogden Dale Road S.E. Calgary, Alberta, Canada	**T2C 4X9**

(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: (403) 319-7000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

As of the close of business on April 16, 2018, there were 143,074,798 of the registrant's Common Shares issued and outstanding.

CANADIAN PACIFIC RAILWAY LIMITED
FORM 10-Q
TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

		Page
Item 1.	Financial Statements:	
	Interim Consolidated Statements of Income For the Three Months Ended March 31, 2018 and 2017	3
	Interim Consolidated Statements of Comprehensive Income For the Three Months Ended March 31, 2018 and 2017	4
	Interim Consolidated Balance Sheets As at March 31, 2018 and December 31, 2017	5
	Interim Consolidated Statements of Cash Flows For the Three Months Ended March 31, 2018 and 2017	6
	Interim Consolidated Statements of Changes in Shareholders' Equity For the Three Months Ended March 31, 2018 and 2017	7
	Notes to Interim Consolidated Financial Statements	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	24
	Executive Summary	24
	Performance Indicators	25
	Financial Highlights	27
	Results of Operations	27
	Liquidity and Capital Resources	33
	Share Capital	35
	Non-GAAP Measures	35
	Off-Balance Sheet Arrangements	41
	Contractual Commitments	41
	Critical Accounting Estimates	42
	Forward-Looking Information	42
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	43
Item 4.	Controls and Procedures	44
	PART II - OTHER INFORMATION	
Item 1.	Legal Proceedings	45
Item 1A.	Risk Factors	45
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	45
Item 3.	Defaults Upon Senior Securities	45
Item 4.	Mine Safety Disclosures	45
Item 5.	Other Information	45
Item 6.	Exhibits	46

2

PART I

ITEM 1. FINANCIAL STATEMENTS

INTERIM CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

	For the three months ended March 31	
(in millions of Canadian dollars, except share and per share data)	**2018**	2017
Revenues		
Freight	**$1,625**	$1,563
Non-freight	**37**	40
Total revenues	**1,662**	1,603
Operating expenses		
Compensation and benefits (Note 2,10 and 11)	**374**	300
Fuel	**215**	170
Materials	**55**	49
Equipment rents	**33**	36
Depreciation and amortization	**170**	166
Purchased services and other	**275**	278
Total operating expenses	**1,122**	999
Operating income	**540**	604
Less:		
Other income and charges (Note 5)	**51**	(28)
Other components of net periodic benefit recovery (Note 2 and 11)	**(96)**	(67)
Net interest expense	**115**	120
Income before income tax expense	**470**	579
Income tax expense (Note 6)	**122**	148
Net income	**$348**	$431
Earnings per share (Note 7)		
Basic earnings per share	**$2.41**	$2.94
Diluted earnings per share	**$2.41**	$2.93
Weighted-average number of shares (millions) (Note 7)		
Basic	**144.4**	146.5
Diluted	**144.8**	147.1
Dividends declared per share	**$0.5625**	$0.5000

Certain of the comparative figures have been reclassified in order to be consistent with the 2018 presentation (Note 2).
See Notes to Interim Consolidated Financial Statements.

INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	For the three months ended March 31	
(in millions of Canadian dollars)	**2018**	2017
Net income	**$ 348**	$ 431
Net (loss) gain in foreign currency translation adjustments, net of hedging activities	**(20)**	5
Change in derivatives designated as cash flow hedges	**21**	5
Change in pension and post-retirement defined benefit plans	**29**	38
Other comprehensive income before income taxes	**30**	48
Income tax recovery (expense) on above items	**6**	(18)
Other comprehensive income (Note 4)	**36**	30
Comprehensive income	**$ 384**	$ 461

See Notes to Interim Consolidated Financial Statements.

INTERIM CONSOLIDATED BALANCE SHEETS AS AT (unaudited)

(in millions of Canadian dollars)	**March 31 2018**	December 31 2017
Assets		
Current assets		
Cash and cash equivalents	**$ 125**	$ 338
Accounts receivable, net	**699**	687
Materials and supplies	**154**	152
Other current assets	**139**	97
	1,117	1,274
Investments	**186**	182
Properties	**17,234**	17,016
Goodwill and intangible assets	**192**	187
Pension asset	**1,507**	1,407
Other assets	**82**	69
Total assets	**$ 20,318**	$ 20,135
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	**$ 1,183**	$ 1,238
Long-term debt maturing within one year (Note 9)	**756**	746
	1,939	1,984
Pension and other benefit liabilities	**749**	749
Other long-term liabilities	**205**	231
Long-term debt (Note 9)	**7,601**	7,413
Deferred income taxes	**3,390**	3,321
Total liabilities	**13,884**	13,698
Shareholders' equity		
Share capital	**2,022**	2,032
Additional paid-in capital	**45**	43
Accumulated other comprehensive loss (Note 4)	**(1,705)**	(1,741)
Retained earnings	**6,072**	6,103
	6,434	6,437
Total liabilities and shareholders' equity	**$ 20,318**	$ 20,135

Contingencies (Note 12)
See Notes to Interim Consolidated Financial Statements.

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	For the three months ended March 31	
(in millions of Canadian dollars)	**2018**	2017
Operating activities		
Net income	**$348**	$431
Reconciliation of net income to cash provided by operating activities:		
Depreciation and amortization	**170**	166
Deferred income taxes (Note 6)	**41**	67
Pension recovery and funding (Note 11)	**(72)**	(60)
Foreign exchange loss (gain) on long-term debt (Note 5)	**49**	(28)
Other operating activities, net	**(21)**	(85)
Change in non-cash working capital balances related to operations	**(118)**	(180)
Cash provided by operating activities	**397**	311
Investing activities		
Additions to properties	**(241)**	(230)
Proceeds from sale of properties and other assets	**4**	3
Other	**(1)**	5
Cash used in investing activities	**(238)**	(222)
Financing activities		
Dividends paid	**(82)**	(73)
Issuance of CP Common Shares	**8**	28
Purchase of CP Common Shares (Note 8)	**(298)**	—
Repayment of long-term debt, excluding commercial paper	**(5)**	(5)
Cash used in financing activities	**(377)**	(50)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	**5**	(2)
Cash position		
(Decrease) increase in cash and cash equivalents	**(213)**	37
Cash and cash equivalents at beginning of period	**338**	164
Cash and cash equivalents at end of period	**$125**	$201
Supplemental disclosures of cash flow information:		
Income taxes paid	**$104**	$170
Interest paid	**$143**	$150

See Notes to Interim Consolidated Financial Statements.

INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (unaudited)

(in millions of Canadian dollars except per share data)	**Common shares (in millions)**	**Share capital**	**Additional paid-in capital**	**Accumulated other comprehensive loss**	**Retained earnings**	**Total shareholders' equity**
Balance at January 1, 2018	**144.9**	**$2,032**	**$ 43**	**$ (1,741)**	**$ 6,103**	**$ 6,437**
Net income	**—**	**—**	**—**	**—**	**348**	**348**
Other comprehensive income (Note 4)	**—**	**—**	**—**	**36**	**—**	**36**
Dividends declared	**—**	**—**	**—**	**—**	**(81)**	**(81)**
Effect of stock-based compensation expense	**—**	**—**	**4**	**—**	**—**	**4**
CP Common Shares repurchased (Note 8)	**(1.3)**	**(20)**	**—**	**—**	**(298)**	**(318)**
Shares issued under stock option plan	**0.1**	**10**	**(2)**	**—**	**—**	**8**
Balance at March 31, 2018	**143.7**	**$2,022**	**$ 45**	**$ (1,705)**	**$ 6,072**	**$ 6,434**
Balance at January 1, 2017	146.3	$2,002	$ 52	$ (1,799)	$ 4,371	$ 4,626
Net income	—	—	—	—	431	431
Other comprehensive income (Note 4)	—	—	—	30	—	30
Dividends declared	—	—	—	—	(73)	(73)
Effect of stock-based compensation expense	—	—	(3)	—	—	(3)
Shares issued under stock option plan	0.4	34	(7)	—	—	27
Balance at March 31, 2017	146.7	$2,036	$ 42	$ (1,769)	$ 4,729	$ 5,038

See Notes to Interim Consolidated Financial Statements.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2018
(unaudited)

1 Basis of presentation

These unaudited interim consolidated financial statements of Canadian Pacific Railway Limited ("CP", or "the Company"), expressed in Canadian dollars, reflect management's estimates and assumptions that are necessary for their fair presentation in conformity with generally accepted accounting principles in the United States of America ("GAAP"). They do not include all disclosures required under GAAP for annual financial statements and should be read in conjunction with the 2017 annual consolidated financial statements and notes included in CP's 2017 Annual Report on Form 10-K. The accounting policies used are consistent with the accounting policies used in preparing the 2017 annual consolidated financial statements, except for the newly adopted accounting policies discussed in Note 2.

CP's operations can be affected by seasonal fluctuations such as changes in customer demand and weather-related issues. This seasonality could impact quarter-over-quarter comparisons.

In management's opinion, the unaudited interim consolidated financial statements include all adjustments (consisting of normal and recurring adjustments) necessary to present fairly such information. Interim results are not necessarily indicative of the results expected for the fiscal year.

2 Accounting changes

Implemented in 2018

Revenue from Contracts with Customers

On January 1, 2018, the Company adopted the new Accounting Standards Update ("ASU") 2014-09, issued by the Financial Accounting Standards Board ("FASB"), and all related amendments under FASB Accounting Standards Codification ("ASC") Topic 606, Revenue from Contracts with Customers, using the modified retrospective method. Comparative financial information has not been restated and continues to be reported under the accounting standards in effect for those periods. The Company did not recognize any adjustment to the opening balance of retained earnings upon adoption of ASC Topic 606. The Company expects the impact of adoption of this new standard to be immaterial to the Company's net income on an ongoing basis.

Compensation - Retirement Benefits

On January 1, 2018, the Company adopted the changes required under ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Post-retirement Benefit Cost under FASB ASC Topic 715, Retirement Benefits as issued by the FASB in March 2017. In accordance with the ASU, beginning on January 1, 2018, the Company reports the current service cost component of net periodic benefit cost in Compensation and benefits on the Company's Consolidated Statements of Income, and reports the Other components of net periodic benefit cost as a separate item outside of Operating income on the Company's Consolidated Statements of Income. The Company has applied these changes in presentation retrospectively, which resulted in a decrease in Operating income of $67 million for the three months ended March 31, 2017.

These changes in presentation do not result in any changes to net income or earnings per share. Details of the components of net periodic benefit costs are provided in Note 11 Pensions and other benefits.

The ASU also prospectively restricts capitalization of net periodic benefit costs to the current service cost component when applicable. This restriction has no impact on the Company's operating income or amounts capitalized because the Company has and continues to only capitalize an appropriate portion of current service cost for self-constructed properties.

Derivatives and Hedging

In August 2017, the FASB issued ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities, under FASB ASC Topic 815, Derivatives and Hedging. This improves the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. These amendments also make targeted improvements to simplify the application of the hedge accounting guidance in GAAP. The amendments require the entire change in the fair value of the hedging instrument to be recorded in Other comprehensive income for effective cash flow hedges. Consequently, any ineffective portion of the change in fair value will no longer be recorded to the Consolidated Statement of Income as it arises. While the amendments are effective for public entities beginning on January 1, 2019, early adoption is permitted and the Company early adopted this ASU effective January 1, 2018. Entities are required to apply the amendments in this update to hedging relationships existing on the date of adoption, reflected as a cumulative-effect adjustment as of the beginning of the fiscal year of adoption. Other amendments to presentation and disclosure are applied prospectively. No significant cumulative-effect adjustment was required.

Accumulated Other Comprehensive Income - Reclassification

In February 2018, the FASB issued ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income under FASB ASC Topic 220, Income Statement - Reporting Comprehensive Income. The current standard ASC Topic 740, Income Taxes, requires deferred tax liabilities and assets to be adjusted for the effect of a change in tax laws or rates with the effect included in income from continuing operations in the reporting period that includes the enactment date. This includes the tax effects of items in Accumulated other comprehensive income ("AOCI") that were originally recognized in Other comprehensive income, subsequently creating stranded tax effects. This ASU allows a reclassification from AOCI to Retained earnings for stranded tax effects specifically resulting from the U.S. federal government's recently enacted tax bill, the Tax Cuts and Jobs Act. The amendments are effective for public entities beginning on January 1, 2019 and early adoption is permitted. Entities are required to apply these amendments either in the period of adoption or retrospectively to each period in which the effect of the change in tax rate from the Tax Cuts and Jobs Act was recognized. The Company early adopted this ASU effective January 1, 2018, electing not to change AOCI or Retained earnings on the Company's Interim Consolidated Financial Statements or disclosure.

Future changes

Leases

In February 2016, the FASB issued ASU 2016-02, Leases under FASB ASC Topic 842, Leases which will supersede the lease recognition and measurement requirements in Topic 840, Leases. This new standard requires recognition of right-of-use assets and lease liabilities by lessees for those leases classified as finance and operating leases with a maximum term exceeding 12 months. For CP this new standard will be effective for interim and annual periods commencing January 1, 2019. Current transitional guidance requires entities to use a modified retrospective approach to adopt this new standard. The Company has a detailed plan to implement the new standard and, through a cross functional team, is assessing contractual arrangements that may qualify as leases under the new standard. CP is also working with a vendor to implement a lease management system which will assist in delivering the required accounting changes. CP's cross functional team and the vendor finalized system requirements and developed work flows and testing scenarios that will permit system implementation and parallel testing later in 2018 for CP's lease system solution. The cross-functional team is assessing policy choices, permitted under the new standard, that can facilitate transition. The impact of the new standard will be a material increase to right of use assets and lease liabilities on the consolidated balance sheet, primarily, as a result of operating leases currently not recognized on the balance sheet. The Company does not anticipate a material impact to Net income as a result of the adoption of this new standard and is currently evaluating disclosure requirements.

3 Revenues

Revenue is recognized when obligations under the terms of a contract with a customer are satisfied. Revenue is measured as the amount of consideration the Company expects to receive in exchange for providing services. Government imposed taxes that the Company collects concurrent with revenue generating activities are excluded from revenue. In the normal course of business the Company does not generate any material revenue through acting as an agent for other entities.
The following is a description of primary activities from which the Company generates revenue.

Freight revenues

The Company provides rail freight transportation services to a wide variety of customers and transports bulk commodities, merchandise freight and intermodal traffic. The Company signs master service agreements with customers that dictate future services the Company is to perform for a customer at the time a bill of lading or service request is received. Each bill of lading or service request represents a separate distinct performance obligation that the Company is obligated to satisfy. The transaction price is generally in the form of a fixed fee determined at the inception of the bill of lading or service request. The Company allocates the transaction price to each distinct performance obligation based on the estimated standalone selling price for each performance obligation. As each bill of lading or service request represents a separate distinct performance obligation, the estimated standalone selling price is assessed at an observable price which is fair market value. Certain customer agreements include variable consideration in the form of rebates, discounts, or incentives. The expected value method is used to estimate variable consideration and is allocated to the applicable performance obligation and is recognized when the related performance obligation is satisfied. Additionally, the Company offers published rates for services through public tariff agreements in which a customer can request service, triggering a performance obligation the Company must satisfy. In accordance with ASC Topic 606, railway freight revenues continue to be recognized over time as services are provided based on the percentage of completed service method. Volume rebates to customers are accrued as a reduction of freight revenues based on estimated volumes and contract terms as freight service is provided. Freight revenues also include certain ancillary and other services provided in association with the performance of rail freight movements. Revenues from these activities are not material and therefore have been aggregated with the freight revenues from customer contracts with which they are associated.

Non-freight revenues

In accordance with ASC Topic 606, non-freight revenues, including passenger revenues, switching fees, and revenues from logistic services, continue to be recognized at the point in time the services are provided or when the performance obligations are satisfied. Non-freight revenues also include leasing revenues.

Disaggregation of revenue

The following table disaggregates the Company's revenues from contracts with customers by major source:

(in millions of Canadian dollars)	For the three months ended March 31 2018	2017[(1)]
Freight		
Grain	**$357**	$393
Coal	**151**	148
Potash	**112**	98
Fertilizers and sulphur	**61**	59
Forest products	**66**	67
Energy, chemicals and plastics	**257**	227
Metals, minerals, and consumer products	**183**	170
Automotive	**71**	76
Intermodal	**367**	325
Total freight revenues	**1,625**	1,563
Non-freight excluding leasing revenues	**23**	28
Revenues from contracts with customers	**1,648**	1,591
Leasing revenues	**14**	12
Total revenues	**$1,662**	**$1,603**

(1) Prior period amounts have not been adjusted under the modified retrospective method.

Satisfying performance obligations

Payment by customers is due upon satisfaction of performance obligations. Payment terms are such that amounts outstanding at the period end are expected to be collected within one reporting period. The Company invoices customers at the time the bill of lading or service request is processed and therefore the Company has no material unbilled receivables and no contract assets. All performance obligations not fully satisfied at period end are expected to be satisfied within the reporting period immediately following.

4 Changes in Accumulated other comprehensive loss ("AOCL") by component

(in millions of Canadian dollars)	For the three months ended March 31: Foreign currency net of hedging activities[(1)]	Derivatives and other[(1)]	Pension and post-retirement defined benefit plans[(1)]	Total[(1)]
Opening balance, January 1, 2018	**$109**	**$ (89)**	**$ (1,761)**	**$(1,741)**
Other comprehensive income before reclassifications	**—**	**13**	**(1)**	**12**
Amounts reclassified from accumulated other comprehensive loss	**—**	**2**	**22**	**24**
Net current-period other comprehensive income	**—**	**15**	**21**	**36**
Closing balance, March 31, 2018	**$109**	**$ (74)**	**$ (1,740)**	**$(1,705)**
Opening balance, January 1, 2017	$127	$ (104)	$ (1,822)	$(1,799)
Other comprehensive (loss) income before reclassifications	(2)	2	—	—
Amounts reclassified from accumulated other comprehensive loss	—	2	28	30
Net current-period other comprehensive (loss) income	(2)	4	28	30
Closing balance, March 31, 2017	$125	$ (100)	$ (1,794)	$(1,769)

(1) Amounts are presented net of tax.

10

Amounts in Pension and post-retirement defined benefit plans reclassified from AOCL are as follows:

	For the three months ended March 31	
(in millions of Canadian dollars)	**2018**	2017
Amortization of prior service costs[(1)]	**$(1)**	$(1)
Recognition of net actuarial loss[(1)]	**30**	39
Total before income tax	**29**	38
Income tax recovery	**(7)**	(10)
Net of income tax	**$22**	$28

(1) Impacts Other components of net periodic benefit recovery on the Interim Consolidated Statements of Income.

5 Other income and charges

	For the three months ended March 31	
(in millions of Canadian dollars)	**2018**	2017
Foreign exchange loss (gain) on long-term debt	**$ 49**	$ (28)
Other foreign exchange gains	**(1)**	(1)
Other	**3**	1
Total other income and charges	**$ 51**	$ (28)

6 Income taxes

	For the three months ended March 31	
(in millions of Canadian dollars)	**2018**	2017
Current income tax expense	**$81**	$81
Deferred income tax expense	**41**	67
Income tax expense	**$122**	$148

The effective tax rate in the first quarter was 25.92%, compared to 25.60% for the same period in 2017.

For the three months ended March 31, 2018, the effective tax rate excluding the discrete item of the foreign exchange loss of $49 million on the Company's U.S. dollar-denominated debt was 24.75%.

For the three months ended March 31, 2017, the effective tax rate excluding the discrete items of the management transition recovery of $51 million related to the retirement of the Company's Chief Executive Officer and the foreign exchange gain of $28 million on the Company's U.S. dollar-denominated debt, was 26.50%.

7 Earnings per share

At March 31, 2018, the number of shares outstanding was 143.7 million (March 31, 2017 - 146.7 million).

Basic earnings per share have been calculated using net income for the period divided by the weighted-average number of shares outstanding during the period.

The number of shares used in earnings per share calculations is reconciled as follows:

	For the three months ended March 31	
(in millions)	**2018**	2017
Weighted-average basic shares outstanding	**144.4**	146.5
Dilutive effect of stock options	**0.4**	0.6
Weighted-average diluted shares outstanding	**144.8**	147.1

For the three months ended March 31, 2018, there were 0.2 million options excluded from the computation of diluted earnings per share because their effects were not dilutive (three months ended March 31, 2017 - 0.5 million).

8 Shareholders' equity

On May 10, 2017, the Company announced a new normal course issuer bid ("NCIB"), commencing May 15, 2017, to purchase up to 4.38 million Common Shares for cancellation before May 14, 2018. As at March 31, 2018, the Company had purchased 3.3 million Common Shares for $699 million under this NCIB program.

All purchases are made in accordance with the NCIB at prevalent market prices plus brokerage fees, or such other prices that may be permitted by the Toronto Stock Exchange, with consideration allocated to share capital up to the average carrying amount of the shares, and any excess allocated to retained earnings.

The following table provides activities under the share repurchase program:

	For the three months ended March 31	
	2018	2017
Number of Common Shares repurchased[(1)]	**1,435,700**	—
Weighted-average price per share[(2)]	**$ 221.76**	$ —
Amount of repurchase (in millions)[(2)]	**$ 318**	$ —

(1) Includes shares repurchased but not yet canceled at quarter end.

(2) Includes brokerage fees.

9 Financial instruments

A. Fair values of financial instruments

The Company categorizes its financial assets and liabilities measured at fair value into a three-level hierarchy established by GAAP that prioritizes those inputs to valuation techniques used to measure fair value based on the degree to which they are observable. The three levels of the fair value hierarchy are as follows: Level 1 inputs are quoted prices in active markets for identical assets and liabilities; Level 2 inputs, other than quoted prices included within Level 1, are observable for the asset or liability either directly or indirectly; and Level 3 inputs are not observable in the market.

When possible, the estimated fair value is based on quoted market prices and, if not available, it is based on estimates from third party brokers. For non-exchange traded derivatives classified in Level 2, the Company uses standard valuation techniques to calculate fair value. Primary inputs to these techniques include observable market prices (interest, foreign exchange ("FX") and commodity) and volatility, depending on the type of derivative and nature of the underlying risk. The Company uses inputs and data used by willing market participants when valuing derivatives and considers its own credit default swap spread as well as those of its counterparties in its determination of fair value. All derivatives and long-term debt are classified as Level 2.

The carrying values of financial instruments equal or approximate their fair values with the exception of long-term debt:

(in millions of Canadian dollars)	**March 31, 2018**	December 31, 2017
Long-term debt (including current maturities):		
Fair value	**$ 9,598**	$ 9,680
Carrying value	**8,357**	8,159

The estimated fair value of current and long-term borrowings has been determined based on market information where available, or by discounting future payments of principal and interest at estimated interest rates expected to be available to the Company at period end.

B. Financial risk management

Derivative financial instruments

Derivative financial instruments may be used to selectively reduce volatility associated with fluctuations in interest rates, FX rates, the price of fuel and stock-based compensation expense. Where derivatives are designated as hedging instruments, the relationship between the hedging instruments and their associated hedged items is documented, as well as the risk management objective and strategy for the use of the hedging instruments. This documentation includes linking the derivatives that are designated as fair value or cash flow hedges to specific assets or liabilities on the Interim Consolidated Balance Sheets, commitments or forecasted transactions. At the time a derivative contract is entered into and at least quarterly thereafter, an assessment is made as to whether the derivative item is effective in offsetting the changes in fair value or cash flows of the hedged items. The derivative qualifies for hedge accounting treatment if it is effective in substantially mitigating the risk it was designed to address.

It is not the Company's intent to use financial derivatives or commodity instruments for trading or speculative purposes.

FX management

The Company conducts business transactions and owns assets in both Canada and the United States. As a result, the Company is exposed to fluctuations in value of financial commitments, assets, liabilities, income or cash flows due to changes in FX rates. The Company may enter into FX risk management transactions primarily to manage fluctuations in the exchange rate between Canadian and U.S. currencies. FX exposure is primarily mitigated through natural offsets created by revenues, expenditures and balance sheet positions incurred in the same currency. Where appropriate, the Company may negotiate with customers and suppliers to reduce the net exposure.

Net investment hedge

The FX gains and losses on long-term debt are mainly unrealized and can only be realized when U.S. dollar-denominated long-term debt matures or is settled. The Company also has long-term FX exposure on its investment in U.S. affiliates. The majority of the Company's U.S. dollar-denominated long-term debt has been designated as a hedge of the net investment in foreign subsidiaries. This designation has the effect of mitigating volatility on Net income by offsetting long-term FX gains and losses on U.S. dollar-denominated long-term debt and gains and losses on its net investment. The effect of the net investment hedge recognized in "Other comprehensive income" for the three months ended March 31, 2018 was an unrealized FX loss of $151 million (three months ended March 31, 2017 - unrealized FX gain of $46 million).

Interest rate management

The Company is exposed to interest rate risk, which is the risk that the fair value or future cash flows of a financial instrument will vary as a result of changes in market interest rates. In order to manage funding needs or capital structure goals, the Company enters into debt or capital lease agreements that are subject to either fixed market interest rates set at the time of issue or floating rates determined by ongoing market conditions. Debt subject to variable interest rates exposes the Company to variability in interest expense, while debt subject to fixed interest rates exposes the Company to variability in the fair value of debt.

To manage interest rate exposure, the Company accesses diverse sources of financing and manages borrowings in line with a targeted range of capital structure, debt ratings, liquidity needs, maturity schedule, and currency and interest rate profiles. In anticipation of future debt issuances, the Company may enter into forward rate agreements, that are designated as cash flow hedges, to substantially lock in all or a portion of the effective future interest expense. The Company may also enter into swap agreements, designated as fair value hedges, to manage the mix of fixed and floating rate debt.

Forward starting swaps

As at March 31, 2018, the Company had forward starting floating-to-fixed interest rate swap agreements ("forward starting swaps") totaling a notional amount of U.S. $500 million to fix the benchmark rate on cash flows associated with highly probable forecasted issuances of long-term notes (December 31, 2017 - U.S. $500 million). The change in fair value on the forward starting swaps is recorded in "Accumulated other comprehensive loss", net of tax, as cash flow hedges until the highly probable forecasted notes are issued. Subsequent to the notes issuance, amounts in "Accumulated other comprehensive loss" are reclassified to "Net interest expense".

As at March 31, 2018, the total fair value loss of $36 million (December 31, 2017 - fair value loss of $55 million) derived from the forward starting swaps was included in "Accounts payable and accrued liabilities". Changes in fair value from the forward starting swaps for the three months ended March 31, 2018 was a gain of $19 million (three months ended March 31, 2017 - gain of $2 million) and is recorded in "Other comprehensive income". For the three months ended March 31, 2018, a loss of $3 million related to previous forward starting swap hedges has been amortized to "Net interest expense" (three months ended March 31, 2017 - loss of $3 million). The Company expects that during the next twelve months, an additional $11 million of losses will be amortized to "Net interest expense".

10 Stock-based compensation

At March 31, 2018, the Company had several stock-based compensation plans, including stock option plans, various cash settled liability plans and an employee share purchase plan. These plans resulted in an expense for the three months ended March 31, 2018 of $14 million (three months ended March 31, 2017 - recovery of $12 million).

Effective January 31, 2017, Mr. E. Hunter Harrison resigned from all positions held by him at the Company, including as the Company's Chief Executive Officer and a member of the Board of Directors of the Company. In connection with Mr. Harrison's resignation, the Company entered into a separation agreement with Mr. Harrison. Under the terms of the separation agreement, the Company has agreed to a limited waiver of Mr. Harrison's non-competition and non-solicitation obligations.

Effective January 31, 2017, pursuant to the separation agreement, Mr. Harrison forfeited certain pension and post-retirement benefits and agreed to the surrender for cancellation of 22,514 performance share units ("PSU"), 68,612 deferred share units ("DSU"), and 752,145 stock options.

As a result of this agreement, the Company recognized a recovery of $51 million in "Compensation and benefits" in the first quarter of 2017. Of this amount, $27 million related to a recovery from cancellation of certain pension benefits.

Stock option plan

In the three months ended March 31, 2018, under CP's stock option plans, the Company issued 169,968 regular options at the weighted average price of $231.59 per share, based on the closing price on the grant date.

Pursuant to the employee plan, these regular options may be exercised upon vesting, which is between 12 months and 48 months after the grant date, and will expire after seven years.

Under the fair value method, the fair value of the stock options at the grant date was approximately $9 million. The weighted average fair value assumptions were approximately:

	For the three months ended March 31, 2018
Grant price	$231.59
Expected option life (years)[(1)]	5.00
Risk-free interest rate[(2)]	2.23%
Expected stock price volatility[(3)]	25.06%
Expected annual dividends per share[(4)]	$2.2500
Expected forfeiture rate[(5)]	4.5%
Weighted-average grant date fair value per option granted during the period	$54.09

(1) Represents the period of time that awards are expected to be outstanding. Historical data on exercise behaviour, or when available, specific expectations regarding future exercise behaviour, were used to estimate the expected life of the option.

(2) Based on the implied yield available on zero-coupon government issues with an equivalent remaining term at the time of the grant.

(3) Based on the historical stock price volatility of the Company's stock over a period commensurate with the expected term of the option.

(4) Determined by the current annual dividend at the time of grant. The Company does not employ different dividend yields throughout the contractual term of the option.

(5) The Company estimated forfeitures based on past experience. This rate is monitored on a periodic basis.

Performance share unit plan

In the three months ended March 31, 2018, the Company issued 123,798 PSUs with a grant date fair value of approximately $29 million. These units attract dividend equivalents in the form of additional units based on the dividends paid on the Company's Common Shares. PSUs vest and are settled in cash or in CP Common Shares, approximately three years after the grant date, contingent upon CP's performance ("performance factor"). Grant recipients who are eligible to retire and have provided six months of service during the performance period are entitled to the full award. The fair value of PSUs is measured periodically until settlement, using a lattice-based valuation model.

The performance period for PSUs issued in the three months ended March 31, 2018 is January 1, 2018 to December 31, 2020. The performance factors for these PSUs are Return on Invested Capital ("ROIC"), Total Shareholder Return ("TSR") compared to the S&P/TSX Capped Industrial index, and TSR compared to S&P 1500 Road and Rail index.

The performance period for the PSUs issued in 2015 was January 1, 2015 to December 31, 2017. The performance factors for these PSUs were Operating Ratio, ROIC, TSR compared to the S&P/TSX 60 index and TSR compared to Class I railways. The resulting payout was 160% of the Company's average share price that was calculated using the last 30 trading days preceding December 31, 2017. In the first quarter of 2018, payouts occurred on the total outstanding awards, including dividends reinvested totalling $30 million on 82,800 outstanding awards.

Deferred share unit plan

In the three months ended March 31, 2018, the Company granted 7,314 DSUs with a grant date fair value of approximately $2 million. DSUs vest over various periods of up to 48 months and are only redeemable for a specified period after employment is terminated. An expense to income for DSUs is recognized over the vesting period for both the initial subscription price and the change in value between reporting periods.

11 Pension and other benefits

In the three months ended March 31, 2018, the Company made net contributions of $1 million (three months ended March 31, 2017 - $12 million), to its defined benefit pension plans, which is net of a $10 million refund of plan surplus (three months ended March 31, 2017 - $nil). Net periodic benefit costs for defined benefit pension plans and other benefits recognized in the three months ended March 31, 2018 included the following components:

	For the three months ended March 31			
	Pensions		**Other benefits**	
(in millions of Canadian dollars)	**2018**	2017	**2018**	2017
Current service cost (benefits earned by employees)	**$30**	$25	**$ 3**	$ 3
Other components of net periodic benefit (recovery) cost:				
Interest cost on benefit obligation	**110**	113	**4**	5
Expected return on fund assets	**(239)**	(223)	**—**	—
Recognized net actuarial loss	**29**	38	**1**	1
Amortization of prior service costs	**(1)**	(1)	**—**	—
Total other components of net periodic benefit (recovery) cost	**$(101)**	$(73)	**$ 5**	$ 6
Net periodic benefit (recovery) cost	**$(71)**	$(48)	**$ 8**	$ 9

12 Contingencies

In the normal course of its operations, the Company becomes involved in various legal actions, including claims relating to injuries and damage to property. The Company maintains provisions it considers to be adequate for such actions. While the final outcome with respect to actions outstanding or pending at March 31, 2018 cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Company’s financial position or results of operations.

Legal proceedings related to Lac-Mégantic rail accident

On July 6, 2013, a train carrying petroleum crude oil operated by Montreal Maine and Atlantic Railway (“MMAR”) or a subsidiary, Montreal Maine & Atlantic Canada Co. (“MMAC” and collectively the “MMA Group”), derailed in Lac-Mégantic, Québec. The derailment occurred on a section of railway owned and operated by the MMA Group. The previous day CP had interchanged the train to the MMA Group, and after the interchange, the MMA Group exclusively controlled the train.

In the wake of the derailment, MMAC sought court protection in Canada under the Companies’ Creditors Arrangement Act, R.S.C., 1985, c. C-36 and MMAR filed for bankruptcy in the United States. Plans of arrangement have been approved in both Canada and the U.S. (the “Plans”). These Plans provide for the distribution of a fund of approximately $440 million amongst those claiming derailment damages.

A number of legal proceedings, set out below, were commenced after the derailment in Canada and/or in the U.S. against CP and others:

(1) Québec's Minister of Sustainable Development, Environment, Wildlife and Parks (the "Minister") ordered various parties, including CP, to clean up the derailment site (the “Cleanup Order”). CP appealed the Cleanup Order to the Administrative Tribunal of Québec (the “TAQ”). The Minister subsequently served a Notice of Claim seeking $95 million for compensation spent on cleanup. CP filed a contestation of the Notice of Claim with the TAQ (the “TAQ Proceeding”). CP and the Minister agreed to stay the TAQ Proceedings pending the outcome of the Province of Québec's action, described in item (2) below.

(2) Québec’s Attorney General sued CP in the Québec Superior Court initially claiming $409 million in damages, which claim was amended and reduced to $315 million (the “Province’s Action”). The Province’s Action alleges that CP exercised custody or control over the petroleum crude oil until its delivery to Irving Oil, that CP was negligent in its custody and control of the petroleum crude oil and that therefore CP is jointly and severally liable with third parties responsible for the derailment and vicariously liable for the acts and omissions of MMAC.

(3) A class action in the Québec Superior Court on behalf of persons and entities residing in, owning or leasing property in, operating a business in or physically present in Lac-Mégantic at the time of the derailment (the “Class Action”) was certified

against CP, MMAC and the train conductor, Mr. Thomas Harding. The Class Action seeks unquantified damages, including for wrongful death, personal injury, and property damage arising from the derailment. All known wrongful death claimants in the Class Action have opted out and, by court order, cannot re-join the Class Action.

(4) Eight subrogated insurers sued CP in the Québec Superior Court initially claiming approximately $16 million in damages, which claim was amended and reduced to $14 million (the "Promutuel Action") and two additional subrogated insurers sued CP in the Québec Superior Court claiming approximately $3 million in damages (the "Royal Action"). Both Actions contain essentially the same allegations as the Province's Action. The lawsuits do not identify the parties to which the insurers are subrogated,

15

and therefore the extent to which these claims overlap with the proof of claims process under the Plans is difficult to determine at this stage. The Royal Action has been stayed pending the determination of the consolidated proceedings described below.

The Province's Action, the Class Action and the Promutuel Action have been consolidated and will proceed together through the litigation process in the Québec Superior Court. While each Action will remain a separate legal proceeding, there will be a trial to determine liability issues commencing mid-September 2019, and subsequently, if necessary, a trial to determine damages issues.

(5) An adversary proceeding filed by the MMAR U.S. estate representative ("Estate Representative") in Maine accuses CP of failing to abide by certain regulations (the "Adversary Proceeding"). The Estate Representative alleges that CP should not have moved the petroleum crude oil train because an inaccurate classification by the shipper was or should have been known. The Estate Representative seeks damages for MMAR's business value (as yet unquantified) allegedly destroyed by the derailment.

(6) A class action and mass tort action on behalf of Lac-Mégantic residents and wrongful death representatives commenced in Texas and wrongful death and personal injury actions commenced in Illinois and Maine against CP were all removed to and consolidated in Maine (the "Maine Actions"). The Maine Actions allege that CP negligently misclassified and mis-packaged the petroleum crude oil being shipped. On CP's motion, the Maine Actions were dismissed by the Court on several grounds. The plaintiffs are appealing the dismissal decision.

(7) The Trustee (the "WD Trustee") for the wrongful death trust (the "WD Trust"), as defined and established by the Estate Representative under the Plans, asserts Carmack Amendment claims against CP in North Dakota federal court (the "Carmack Claims"). The WD Trustee seeks to recover approximately $6 million for damaged rail cars, and the settlement amounts the consignor and the consignee paid to the bankruptcy estates, alleged to be $110 million and $60 million, respectively. On CP's motion, the federal court in North Dakota dismissed the Carmack Claims. The WD Trustee appealed the dismissal decision. The court in the appeal has reserved judgment.

At this stage of the proceedings, any potential responsibility and the quantum of potential losses cannot be determined. Nevertheless, CP denies liability and is vigorously defending the above noted proceedings.

Environmental liabilities

Environmental remediation accruals, recorded on an undiscounted basis unless a reliable, determinable estimate as to an amount and timing of costs can be established, cover site-specific remediation programs.

The accruals for environmental remediation represent CP's best estimate of its probable future obligation and include both asserted and unasserted claims, without reduction for anticipated recoveries from third parties. Although the recorded accruals include CP's best estimate of all probable costs, CP's total environmental remediation costs cannot be predicted with certainty. Accruals for environmental remediation may change from time to time as new information about previously untested sites becomes known, and as environmental laws and regulations evolve and advances are made in environmental remediation technology. The accruals may also vary as the courts decide legal proceedings against outside parties responsible for contamination. These potential charges, which cannot be quantified at this time, may materially affect income in the particular period in which a charge is recognized. Costs related to existing, but as yet unknown, or future contamination will be accrued in the period in which they become probable and reasonably estimable.

The expense included in "Purchased services and other" for the three months ended March 31, 2018 was $1 million (three months ended March 31, 2017 - $1 million). Provisions for environmental remediation costs are recorded in "Other long-term liabilities", except for the current portion which is recorded in "Accounts payable and accrued liabilities". The total amount provided at March 31, 2018 was $80 million (December 31, 2017 - $78 million). Payments are expected to be made over 10 years through 2027.

13 Condensed consolidating financial information

Canadian Pacific Railway Company, a 100%-owned subsidiary of Canadian Pacific Railway Limited ("CPRL"), is the issuer of certain debt securities, which are fully and unconditionally guaranteed by CPRL. The following tables present condensed consolidating financial information ("CCFI") in accordance with Rule 3-10(c) of Regulation S-X.

Investments in subsidiaries are accounted for under the equity method when presenting the CCFI.

The tables include all adjustments necessary to reconcile the CCFI on a consolidated basis to CPRL's consolidated financial statements for the periods presented.

Interim Condensed Consolidating Statements of Income
For the three months ended March 31, 2018

(in millions of Canadian dollars)	CPRL (Parent Guarantor)	CPRC (Subsidiary Issuer)	Non-Guarantor Subsidiaries	Consolidating Adjustments and Eliminations	CPRL Consolidated
Revenues					
Freight	$ —	$ 1,155	$ 470	$ —	$ 1,625
Non-freight	—	27	89	(79)	37
Total revenues	—	1,182	559	(79)	1,662
Operating expenses					
Compensation and benefits	—	257	115	2	374
Fuel	—	168	47	—	215
Materials	—	35	15	5	55
Equipment rents	—	31	2	—	33
Depreciation and amortization	—	104	66	—	170
Purchased services and other	—	218	143	(86)	275
Total operating expenses	—	813	388	(79)	1,122
Operating income	—	369	171	—	540
Less:					
Other income and charges	6	48	(3)	—	51
Other components of net periodic benefit recovery	—	(96)	—	—	(96)
Net interest expense (income)	8	114	(7)	—	115
(Loss) income before income tax expense and equity in net earnings of subsidiaries	(14)	303	181	—	470
Less: Income tax expense	—	86	36	—	122
Add: Equity in net earnings of subsidiaries	362	145	—	(507)	—
Net income	$ 348	$ 362	$ 145	$ (507)	$ 348

17

Interim Condensed Consolidating Statements of Income
For the three months ended March 31, 2017

(in millions of Canadian dollars)	CPRL (Parent Guarantor)	CPRC (Subsidiary Issuer)	Non-Guarantor Subsidiaries	Consolidating Adjustments and Eliminations	CPRL Consolidated
Revenues					
Freight	$ —	$ 1,089	$ 474	$ —	$ 1,563
Non-freight	—	32	93	(85)	40
Total revenues	—	1,121	567	(85)	1,603
Operating expenses					
Compensation and benefits	—	191	108	1	300
Fuel	—	132	38	—	170
Materials	—	34	9	6	49
Equipment rents	—	36	—	—	36
Depreciation and amortization	—	109	57	—	166
Purchased services and other	—	208	162	(92)	278
Total operating expenses	—	710	374	(85)	999
Operating income	—	411	193	—	604
Less:					
Other income and charges	(20)	(7)	(1)	—	(28)
Other components of net periodic benefit recovery	—	(67)	—	—	(67)
Net interest expense (income)	2	125	(7)	—	120
Income before income tax expense and equity in net earnings of subsidiaries	18	360	201	—	579
Less: Income tax expense	1	98	49	—	148
Add: Equity in net earnings of subsidiaries	414	152	—	(566)	—
Net income	$ 431	$ 414	$ 152	$ (566)	$ 431

Certain of the comparative figures have been reclassified in order to be consistent with the 2018 presentation (Note 2).

Interim Condensed Consolidating Statements of Comprehensive Income
For the three months ended March 31, 2018

(in millions of Canadian dollars)	CPRL (Parent Guarantor)	CPRC (Subsidiary Issuer)	Non-Guarantor Subsidiaries	Consolidating Adjustments and Eliminations	CPRL Consolidated
Net income	$ 348	$ 362	$ 145	$ (507)	$ 348
Net (loss) gain in foreign currency translation adjustments, net of hedging activities	—	(150)	130	—	(20)
Change in derivatives designated as cash flow hedges	—	21	—	—	21
Change in pension and post-retirement defined benefit plans	—	28	1	—	29
Other comprehensive (loss) income before income taxes	—	(101)	131	—	30
Income tax recovery on above items	—	6	—	—	6
Equity accounted investments	36	131	—	(167)	—
Other comprehensive income	36	36	131	(167)	36
Comprehensive income	$ 384	$ 398	$ 276	$ (674)	$ 384

Interim Condensed Consolidating Statements of Comprehensive Income
For the three months ended March 31, 2017

(in millions of Canadian dollars)	CPRL (Parent Guarantor)	CPRC (Subsidiary Issuer)	Non-Guarantor Subsidiaries	Consolidating Adjustments and Eliminations	CPRL Consolidated
Net income	$ 431	$ 414	$ 152	$ (566)	$ 431
Net gain (loss) in foreign currency translation adjustments, net of hedging activities	—	45	(40)	—	5
Change in derivatives designated as cash flow hedges	—	5	—	—	5
Change in pension and post-retirement defined benefit plans	—	36	2	—	38
Other comprehensive income (loss) before income taxes	—	86	(38)	—	48
Income tax expense on above items	—	(17)	(1)	—	(18)
Equity accounted investments	30	(39)	—	9	—
Other comprehensive income (loss)	30	30	(39)	9	30
Comprehensive income	$ 461	$ 444	$ 113	$ (557)	$ 461

Interim Condensed Consolidating Balance Sheets
As at March 31, 2018

(in millions of Canadian dollars)	CPRL (Parent Guarantor)	CPRC (Subsidiary Issuer)	Non-Guarantor Subsidiaries	Consolidating Adjustments and Eliminations	CPRL Consolidated
Assets					
Current assets					
Cash and cash equivalents	$ —	$ 43	$ 82	$ —	$ 125
Accounts receivable, net	—	525	174	—	699
Accounts receivable, inter-company	104	149	205	(458)	—
Short-term advances to affiliates	—	1,313	4,805	(6,118)	—
Materials and supplies	—	121	33	—	154
Other current assets	—	80	143	(84)	139
	104	2,231	5,442	(6,660)	1,117
Long-term advances to affiliates	1,090	—	88	(1,178)	—
Investments	—	27	159	—	186
Investments in subsidiaries	10,944	11,862	—	(22,806)	—
Properties	—	9,016	8,218	—	17,234
Goodwill and intangible assets	—	—	192	—	192
Pension asset	—	1,507	—	—	1,507
Other assets	—	73	9	—	82
Deferred income taxes	4	—	—	(4)	—
Total assets	$ 12,142	$ 24,716	$ 14,108	$ (30,648)	$ 20,318
Liabilities and shareholders' equity					
Current liabilities					
Accounts payable and accrued liabilities	$ 102	$ 886	$ 279	$ (84)	$ 1,183
Accounts payable, inter-company	4	305	149	(458)	—
Short-term advances from affiliates	5,602	508	8	(6,118)	—
Long-term debt maturing within one year	—	756	—	—	756
	5,708	2,455	436	(6,660)	1,939
Pension and other benefit liabilities	—	670	79	—	749
Long-term advances from affiliates	—	1,178	—	(1,178)	—
Other long-term liabilities	—	93	112	—	205
Long-term debt	—	7,549	52	—	7,601
Deferred income taxes	—	1,827	1,567	(4)	3,390
Total liabilities	5,708	13,772	2,246	(7,842)	13,884
Shareholders' equity					
Share capital	2,022	1,038	6,307	(7,345)	2,022
Additional paid-in capital	45	1,648	261	(1,909)	45
Accumulated other comprehensive (loss) income	(1,705)	(1,705)	547	1,158	(1,705)
Retained earnings	6,072	9,963	4,747	(14,710)	6,072
	6,434	10,944	11,862	(22,806)	6,434
Total liabilities and shareholders' equity	$ 12,142	$ 24,716	$ 14,108	$ (30,648)	$ 20,318

Condensed Consolidating Balance Sheets
As at December 31, 2017

(in millions of Canadian dollars)	CPRL (Parent Guarantor)	CPRC (Subsidiary Issuer)	Non-Guarantor Subsidiaries	Consolidating Adjustments and Eliminations	CPRL Consolidated
Assets					
Current assets					
Cash and cash equivalents	$ —	$ 241	$ 97	$ —	$ 338
Accounts receivable, net	—	508	179	—	687
Accounts receivable, inter-company	97	153	215	(465)	—
Short-term advances to affiliates	500	1,004	4,996	(6,500)	—
Materials and supplies	—	120	32	—	152
Other current assets	—	31	66	—	97
	597	2,057	5,585	(6,965)	1,274
Long-term advances to affiliates	590	—	410	(1,000)	—
Investments	—	27	155	—	182
Investments in subsidiaries	10,623	12,122	—	(22,745)	—
Properties	—	8,982	8,034	—	17,016
Goodwill and intangible assets	—	—	187	—	187
Pension asset	—	1,407	—	—	1,407
Other assets	—	56	13	—	69
Deferred income taxes	3	—	—	(3)	—
Total assets	$ 11,813	$ 24,651	$ 14,384	$ (30,713)	$ 20,135
Liabilities and shareholders’ equity					
Current liabilities					
Accounts payable and accrued liabilities	$ 82	$ 844	$ 312	$ —	$ 1,238
Accounts payable, inter-company	3	309	153	(465)	—
Short-term advances from affiliates	5,291	1,185	24	(6,500)	—
Long-term debt maturing within one year	—	746	—	—	746
	5,376	3,084	489	(6,965)	1,984
Pension and other benefit liabilities	—	672	77	—	749
Long-term advances from affiliates	—	1,000	—	(1,000)	—
Other long-term liabilities	—	108	123	—	231
Long-term debt	—	7,362	51	—	7,413
Deferred income taxes	—	1,802	1,522	(3)	3,321
Total liabilities	5,376	14,028	2,262	(7,968)	13,698
Shareholders’ equity					
Share capital	2,032	1,037	6,730	(7,767)	2,032
Additional paid-in capital	43	1,643	259	(1,902)	43
Accumulated other comprehensive (loss) income	(1,741)	(1,742)	417	1,325	(1,741)
Retained earnings	6,103	9,685	4,716	(14,401)	6,103
	6,437	10,623	12,122	(22,745)	6,437
Total liabilities and shareholders’ equity	$ 11,813	$ 24,651	$ 14,384	$ (30,713)	$ 20,135

Interim Condensed Consolidating Statements of Cash Flows
For the three months ended March 31, 2018

(in millions of Canadian dollars)	CPRL (Parent Guarantor)	CPRC (Subsidiary Issuer)	Non-Guarantor Subsidiaries	Consolidating Adjustments and Eliminations	CPRL Consolidated
Cash provided by operating activities	$ 65	$ 392	$ 135	$ (195)	$ 397
Investing activities					
Additions to properties	—	(122)	(119)	—	(241)
Proceeds from sale of properties and other assets	—	3	1	—	4
Advances to affiliates	—	(307)	—	307	—
Repayment of advances to affiliates	—	—	502	(502)	—
Repurchase of share capital from affiliates	—	423	—	(423)	—
Other	—	—	(1)	—	(1)
Cash (used in) provided by investing activities	—	(3)	383	(618)	(238)
Financing activities					
Dividends paid	(82)	(82)	(113)	195	(82)
Return of share capital to affiliates	—	—	(423)	423	—
Issuance of CP Common Shares	8	—	—	—	8
Purchase of CP Common Shares	(298)	—	—	—	(298)
Repayment of long-term debt, excluding commercial paper	—	(5)	—	—	(5)
Advances from affiliates	307	—	—	(307)	—
Repayment of advances from affiliates	—	(502)	—	502	—
Cash used in financing activities	(65)	(589)	(536)	813	(377)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	—	2	3	—	5
Cash position					
Decrease in cash and cash equivalents	—	(198)	(15)	—	(213)
Cash and cash equivalents at beginning of period	—	241	97	—	338
Cash and cash equivalents at end of period	$ —	$ 43	$ 82	$ —	$ 125

Interim Condensed Consolidating Statements of Cash Flows
For the three months ended March 31, 2017

(in millions of Canadian dollars)	CPRL (Parent Guarantor)	CPRC (Subsidiary Issuer)	Non-Guarantor Subsidiaries	Consolidating Adjustments and Eliminations	CPRL Consolidated
Cash provided by operating activities	$ 63	$ 85	$ 264	$ (101)	$ 311
Investing activities					
Additions to properties	—	(109)	(121)	—	(230)
Proceeds from sale of properties and other assets	—	1	2	—	3
Advances to affiliates	(152)	—	(134)	286	—
Capital contributions to affiliates	—	(68)	—	68	—
Other	—	5	—	—	5
Cash used in investing activities	(152)	(171)	(253)	354	(222)
Financing activities					
Dividends paid	(73)	(73)	(28)	101	(73)
Issuance of share capital	—	—	68	(68)	—
Issuance of CP Common Shares	28	—	—	—	28
Repayment of long-term debt, excluding commercial paper	—	(5)	—	—	(5)
Advances from affiliates	134	149	3	(286)	—
Cash provided by (used in) financing activities	89	71	43	(253)	(50)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	—	(2)	—	—	(2)
Cash position					
(Decrease) increase in cash and cash equivalents	—	(17)	54	—	37
Cash and cash equivalents at beginning of period	—	100	64	—	164
Cash and cash equivalents at end of period	$ —	$ 83	$ 118	$ —	$ 201

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the Company's Interim Consolidated Financial Statements and the related notes for the three months ended March 31, 2018 in Item 1. Financial Statements, other information in this report, and Item 8. Financial Statements and Supplementary Data of the Company's 2017 Annual Report on Form 10-K. Except where otherwise indicated, all financial information reflected herein is expressed in Canadian dollars.

For purposes of this report, all references herein to “CP”, “the Company”, “we”, “our” and “us” refer to CPRL, CPRL and its subsidiaries, CPRL and one or more of its subsidiaries, or one or more of CPRL's subsidiaries, as the context may require.

In the first quarter of 2018, the comparative figures contained in or derived from the Consolidated Statement of Income were restated to reflect the adoption of the new Accounting Standards Update ("ASU") ASU 2017-07 for presentation of net periodic benefit recovery. These changes in presentation do not result in any changes to net income or earnings per share. For further information, refer to Item 1. Financial Statements, Note 2 Accounting Changes.

Available Information

CP makes available on or through its website www.cpr.ca free of charge, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports as soon as reasonably practicable after such reports are filed with or furnished to the Securities and Exchange Commission (“SEC”). Our website also contains charters for our Board of Directors and each of its committees, our corporate governance guidelines and our Code of Business Ethics. SEC filings made by CP are also accessible through the SEC’s website at www.sec.gov. The information on our website is not part of this quarterly report on Form 10-Q.

The Company has included the Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) certifications regarding the Company's public disclosure required by Section 302 of the Sarbanes-Oxley Act of 2002 as Exhibits to this report.

Executive Summary

First Quarter of 2018 Results

- *Financial performance* - In the first quarter of 2018, CP reported Diluted earnings per share ("EPS") of $2.41, a decrease of 18% as compared to 2017 primarily due to foreign exchange ("FX") losses on U.S. dollar-denominated debt in 2018 and a management transition recovery in 2017. Adjusted diluted EPS, which excludes these two factors, was $2.70 in the first quarter of 2018, an increase of 8% compared to last year primarily due to higher volumes.

CP reported Net income of $348 million in the first quarter of 2018, a decrease of 19% as compared to 2017, primarily due to the FX losses and the prior year transition recovery described above. Adjusted income, which excludes these two factors, was $390 million in the first quarter of 2018, an increase of 6% compared to last year primarily due to higher volumes.

CP reported an Operating ratio of 67.5% in the first quarter of 2018, a 510 basis point increase and a 190 basis points increase as compared to last year's operating ratio and adjusted operating ratio, respectively. Operating ratio was adjusted in 2017 to remove the effects of the management transition recovery. Excluding this adjustment, the increase was primarily due to additional costs caused by hasher winter operating conditions, cost inflation and higher fuel prices, partially offset by the contribution from higher volumes.

Adjusted diluted EPS, Adjusted income, and Adjusted operating ratio are defined and reconciled in Non-GAAP Measures and discussed further in Results of Operations of this Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

- *Total revenues* - Total revenues increased by 4% in the first quarter of 2018 to $1,662 million from $1,603 million in the same period in 2017. This increase was driven primarily by a 6% volume growth as measured in revenue ton miles ("RTMs"), partially offset by the unfavorable impact of the change in FX.

- *Operating performance* - CP's average train speed decreased by 8% to 20.6 miles per hour and terminal dwell time increased by 11% to 7.9 hours as a result of harsher winter operating conditions. Average train weight increased by 4% to 8,989 tons and average train length increased by 1% to 7,229 feet, primarily driven by mix of business and productivity improvements. These metrics are discussed further in Performance Indicators of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Recent Development

On April 18, 2018, CP received 72-hour strike notice from the Teamsters Canada Rail Conference-Train & Engine ("TCRC") and the International Brotherhood of Electrical Workers ("IBEW") of their respective plans to strike at 12:01 a.m. eastern time on April 21, 2018. CP continues to work closely with the TCRC and the IBEW to reach a negotiated settlement.

Performance Indicators

The following table lists the key measures of the Company's operating performance:

	For the three months ended March 31		
	2018	2017[(1)]	% Change
Operations Performance			
Gross ton-miles ("GTMs") (millions)	**64,411**	60,827	6
Train miles (thousands)	**7,642**	7,511	2
Average train weight – excluding local traffic (tons)	**8,989**	8,647	4
Average train length – excluding local traffic (feet)	**7,229**	7,143	1
Average terminal dwell (hours)	**7.9**	7.1	11
Average train speed (miles per hour, or "mph")	**20.6**	22.3	(8)
Fuel efficiency (U.S. gallons of locomotive fuel consumed / 1,000 GTMs)	**0.984**	1.012	(3)
Total Employees and Workforce			
Total employees (average)	**12,173**	11,648	5
Total employees (end of period)	**12,328**	11,794	5
Workforce (end of period)	**12,398**	11,829	5
Safety Indicators			
FRA personal injuries per 200,000 employee-hours	**1.74**	1.85	(6)
FRA train accidents per million train miles	**1.07**	0.85	26

(1) Certain figures have been updated to reflect new information or have been revised to conform with current presentation.

Operations Performance

These key measures of operating performance reflect how effective CP's management is at controlling costs and executing the Company's operating plan and strategy. CP continues to drive further productivity improvements in its operations, allowing the Company to deliver superior service and grow its business at low incremental cost.

Three months ended March 31, 2018 compared to the three months ended March 31, 2017

- A **GTM** is the movement of one ton of train weight over one mile. GTMs are calculated by multiplying total train weight by the distance the train moved. Total train weight comprises the weight of the freight cars, their contents, and any inactive locomotives. An increase in GTMs indicates additional workload. GTMs for the first quarter of 2018 were 64,411, an increase of 6% compared with 60,827 in the same period of 2017. This increase was primarily due to increased volumes of Intermodal, Potash, crude, and frac sand, partially offset by decreases in Grain.

- **Train miles** are defined as the sum of the distance moved by all trains operated on the network. Train miles increased by 2% for the first quarter of 2018 compared to the same period of 2017. This reflects the impact of a 6% increase in workload, as measured in GTMs, partially offset by continuous improvements in train weights.

- The **average train weight** is defined as the average gross weight of CP trains, both loaded and empty. This excludes trains in short-haul service, work trains used to move CP's track equipment and materials, and the haulage of other railways' trains on CP's network. Average train weight increased by 4% for the first quarter of 2018 compared to the same period of 2017. This increase was due to continuous improvements in operating plan efficiency and bulk train weights, as well as higher volumes of heavier commodities such as Potash, crude and frac sand compared to the same period in 2017. These improvements were partially offset by lower volumes of Grain moving in shorter, lighter trains due to harsher winter operating conditions.

- The **average train length** is defined as the average total length of CP trains, both loaded and empty. This includes all cars and locomotives on the train and is calculated as the sum of each car or locomotive's length multiplied by the distance travelled, divided by train miles. Local trains are excluded from this measure. Average train length increased by 1% for the first quarter of 2018 compared to the same period of 2017. This is a result of improvements in operating plan efficiency and increased Intermodal, Potash and export Coal volumes which move in longer trains. These improvements were partially offset by lower volumes of Grain moving in shorter trains due to harsher winter operating conditions.

- The **average terminal dwell** is defined as the average time a freight car resides within terminal boundaries expressed in hours. The timing starts with a train arriving at the terminal, a customer releasing the car to the Company, or a car arriving at interchange from another railway. The timing ends when the train leaves, a customer receives the car from CP, or the freight car is transferred to another railway. Freight cars are excluded if they are being stored at the terminal or used in track repairs. Average terminal dwell increased by 11% in the first quarter of 2018 compared to the same period of 2017. This unfavourable increase was primarily due to harsher winter operating conditions and network disruptions as compared to the same period in 2017.

- The **average train speed** is defined as a measure of the line-haul movement from origin to destination including terminal dwell hours. It is calculated by dividing the total train miles travelled by the total train hours operated. This calculation does not include delay time related to customer or foreign railways and excludes the time and distance travelled by: i) trains used in or around CP's yards; ii) passenger trains; and iii) trains used for repairing track. Average train speed decreased by 8% in the first quarter of 2018 compared to the same period of 2017. This unfavourable decrease was primarily due to harsher winter operating conditions and network disruptions as compared to the same period in 2017.

- **Fuel efficiency** is defined as U.S. gallons of locomotive fuel consumed per 1,000 GTMs - freight and yard. Fuel efficiency improved by 3% in the first quarter of 2018 compared to the same period of 2017. Improvements in fuel efficiency were primarily due to increased train capacity utilization as a result of volume growth.

Total Employees and Workforce

An **employee** is defined as an individual currently engaged in full-time, part-time or seasonal employment with CP. The average number of total employees increased by 5% in the first three months of 2018, compared to the same periods of 2017 to accommodate current and anticipated volume growth.

The **workforce** is defined as total employees plus contractors and consultants. The Company's total workforce as at March 31, 2018, was 12,398, an increase of 156, when compared to 12,242 as at December 31, 2017. As at March 31, 2018, the total workforce increased by 569, or 5%, compared to March 31, 2017. The increase in workforce is to accommodate current and anticipated volume growth.

Safety Indicators

Safety is a key priority and core strategy for CP's management, employees and Board of Directors. The Company's two main safety indicators – personal injuries and train accidents – follow strict U.S. Federal Railroad Administration ("FRA") reporting guidelines.

The **FRA personal injuries per 200,000 employee-hours** frequency is the number of personal injuries multiplied by 200,000 and divided by total employee hours. Personal injuries are defined as injuries that require employees to lose time away from work, modify their normal duties or obtain medical treatment beyond minor first aid. FRA employee-hours are the total hours worked, excluding vacation and sick time, by all employees, excluding contractors. The FRA personal injuries per 200,000 employee-hours frequency for CP was 1.74 in the first quarter of 2018, a decrease from 1.85 in the same period of 2017.

The **FRA train accidents per million train miles** frequency is the number of train accidents, multiplied by 1,000,000 and divided by total train miles. Train accidents included in this metric meet or exceed the FRA reporting threshold of U.S. $10,700 in damage. The FRA train accidents per million train miles was 1.07 in the first quarter of 2018, an increase from 0.85 in the same period of 2017.

Financial Highlights

The following table presents selected financial data related to the Company's financial results as of, and for the first quarter ended March 31, 2018 and the comparative figures in 2017. The financial highlights should be read in conjunction with Item 1. Financial Statements and this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

	For the three months ended March 31	
(in millions, except per share data, percentages and ratios)	**2018**	2017
Financial Performance		
Revenues	**$1,662**	$1,603
Operating income[1]	**540**	604
Adjusted operating income[1][2]	**540**	553
Net income	**348**	431
Adjusted income[2]	**390**	368
Basic EPS	**2.41**	2.94
Diluted EPS	**2.41**	2.93
Adjusted diluted EPS[2]	**2.70**	2.50
Dividends declared per share	**0.5625**	0.5000
Cash provided by operating activities	**397**	311
Free cash[2]	**164**	87
	As at March 31, 2018	As at December 31, 2017
Financial Position		
Total assets	**$20,318**	$20,135
Total long-term debt, including current portion	**8,357**	8,159
Shareholders' equity	**6,434**	6,437
	For the twelve months ended March 31	
	2018	2017
Financial Ratios		
Return on invested capital ("ROIC")[2]	**19.5 %**	13.4 %
Adjusted ROIC[2]	**14.6 %**	13.7 %
Operating ratio[1][3]	**67.5 %**	62.4 %
Adjusted operating ratio[1][2]	**67.5 %**	65.6 %

(1) 2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.

(2) These measures have no standardized meanings prescribed by accounting principles generally accepted in the United States of America ("GAAP") and, therefore, may not be comparable to similar measures presented by other companies. These measures are defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(3) Operating ratio is defined as operating expenses divided by revenues, further discussed in Results of Operations of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Results of Operations

Three months ended March 31, 2018 compared to the three months ended March 31, 2017

Income

Operating income was $540 million in the first quarter of 2018, a decrease of $64 million, or 11%, from $604 million in the same period of 2017. This decrease was primarily due to:

- management transition recovery of $51 million associated with Mr. E. Hunter Harrison's retirement as CEO of CP in 2017;
- harsher winter operating conditions
- the unfavourable impact of the change in FX of $16 million;

- cost inflation consisting primarily of wage and benefit inflation of approximately 3%;
- higher depreciation and amortization expense; and
- higher defined benefit current service costs.

This decrease was partially offset by higher volumes and efficiencies generated from improved operating performance and asset utilization.

Adjusted operating income, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $540 million in the first quarter of 2018, a decrease of $13 million, or 2% from $553 million in the first quarter of 2017. This decrease reflects the same factors discussed above, except that Adjusted operating income in 2017 excludes the management transition recovery of $51 million.

Net income was $348 million in the first quarter of 2018, a decrease of $83 million, or 19%, from $431 million in the same period of 2017. This decrease was primarily due to the unfavourable impact of FX translation on U.S. dollar-denominated debt and lower Operating income. This decrease was partially offset by higher income from other components of net periodic benefit recoveries and lower income tax expense associated with lower pre-tax earnings.

Adjusted income, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $390 million in the first quarter of 2018, an increase of $22 million, or 6%, from $368 million in the same period of 2017. This increase was primarily due to higher income from other components of net periodic benefits recoveries and lower income tax expense associated with a lower effective tax rate, partially offset by lower Adjusted operating income.

Diluted Earnings per Share

Diluted earnings per share was $2.41 in the first quarter of 2018, a decrease of $0.52, or 18%, from $2.93 in the same period of 2017. This decrease was primarily due to lower Net income, partially offset by lower average outstanding shares due to the Company's share repurchase program.

Adjusted diluted EPS, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was $2.70 in the first quarter of 2018, an increase of $0.20, or 8%, from $2.50 in the same period of 2017. This increase was primarily due to higher Adjusted income and lower average outstanding shares due to the Company's share repurchase program.

Operating Ratio

The Operating ratio provides the percentage of revenues used to operate the railway. A lower percentage normally indicates higher efficiency in the operation of the railway. The Company's Operating ratio was 67.5% in the first quarter of 2018, a 510 basis point increase from 62.4% in the same period of 2017. This increase was primarily due to:

- management transition recovery of $51 million associated with Mr. E. Hunter Harrison's retirement as CEO of CP in 2017;
- harsher winter operating conditions;
- cost inflation consisting primarily of wage and benefit inflation of approximately 3%; and
- the unfavourable impact of changes in fuel prices.

This increase was partially offset by higher volumes.

Adjusted operating ratio, defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, was 67.5% in the first quarter of 2018, a 190 basis point increase from 65.6% in the same period of 2017. This increase reflects the same factors discussed above except that Adjusted operating ratio for 2017 excludes the impact of the management transition recovery of 320 basis points.

Return on Invested Capital (ROIC)

ROIC is a measure of how productively the Company uses its long-term capital investments, representing critical indicators of good operating and investment decisions made by management, and is an important performance criteria in determining certain elements of the Company's long-term incentive plan. ROIC was 19.5% for the twelve months ended March 31, 2018, a 610 basis point increase compared to 13.4% for the twelve months ended March 31, 2017. The increase was due to:

- lower tax expense due to income tax rate changes;
- favourable FX translation on U.S. dollar-denominated debt; and
- higher other components of net periodic benefit recoveries.

This increase is partially offset by a higher invested capital base due to higher Retained earnings from Net income.

Adjusted ROIC was 14.6% for the twelve months ended March 31, 2018, a 90 basis point increase compared to 13.7% for the twelve months ended March 31, 2017. This increase was primarily due to higher other components of net periodic benefit recoveries and higher Adjusted operating income, partially offset by the increase in adjusted average Shareholders' equity primarily due to higher Net income. ROIC and Adjusted ROIC are defined and reconciled in Non-GAAP Measures of this Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Impact of FX on Earnings

Fluctuations in FX affect the Company's results because U.S. dollar-denominated revenues and expenses are translated into Canadian dollars. U.S. dollar-denominated revenues and expenses increase (decrease) when the Canadian dollar weakens (strengthens) in relation to the U.S. dollar. The following tables indicate the average and periodic exchange rates when converting U.S. dollars to Canadian dollars for the three months ended March 31, 2018 and the comparative periods in 2017.

Average exchange rates (Canadian/U.S. dollar)	**2018**	2017
For the three months ended - March 31	**$1.26**	$1.32

Exchange rates (Canadian/U.S. dollar)	**2018**	2017
Beginning of quarter - January 1	**$1.25**	$1.34
End of quarter - March 31	**$1.29**	$1.33

In the first quarter of 2018, the impact of a weaker U.S. dollar resulted in a decrease in total revenues of $37 million, a decrease in total operating expenses of $21 million and a decrease in interest expense of $4 million from the same period in 2017.

The impact of FX on total revenues and operating expenses is discussed further in Item 3. Quantitative and Qualitative Disclosures About Market Risk, in the Foreign Exchange Risk section.

Impact of Fuel Price on Earnings

Fluctuations in fuel prices affect the Company's results because fuel expense constitutes a significant portion of CP's operating costs. As fuel prices fluctuate, there will be a timing impact on earnings. The following table indicates the average fuel price for the three months ended March 31, 2018 and the comparative periods in 2017.

Average Fuel Price (U.S. dollars per U.S. gallon)	**2018**	2017
For the three months ended - March 31	**$2.70**	$2.11

The impact of fuel price on earnings includes the impacts of carbon taxes, levies, and obligations under cap-and-trade programs recovered and paid, on revenues and expenses, respectively.

In the first quarter of 2018, the impact of higher fuel prices resulted in an increase in total revenues of $42 million and an increase in total operating expenses of $40 million from the same period in 2017.

Impact of Share Price on Earnings

Fluctuations in the Common Share price affect the Company's operating expenses because share-based liabilities are measured at fair value. The following tables indicate the opening and closing CP Common Share Price on the Toronto Stock Exchange ("TSX") and the New York Stock Exchange ("NYSE") for the three months ended March 31, 2018 and the comparative period in 2017.

TSX (in Canadian dollars)	**2018**	2017
Opening Common Share Price, as at January 1	**$229.66**	$191.56
Ending Common Share Price, as at March 31	**$227.20**	$195.35
Change in Common Share Price	**$(2.46)**	$3.79
NYSE (in U.S. dollars)	**2018**	2017
Opening Common Share Price, as at January 1	**$182.76**	$142.77
Ending Common Share Price, as at March 31	**$176.50**	$146.92
Change in Common Share Price	**$(6.26)**	$4.15

In the first quarter of 2018, the impact of the change in Common Share prices resulted in a decrease in stock-based compensation expense of $2 million compared to an increase of $2 million in the same period in 2017.

The impact of share price on stock-based compensation is discussed further in Item 3. Quantitative and Qualitative Disclosures About Market Risk, in the Share Price Impact on Stock-Based Compensation section.

Operating Revenues

The Company's revenues are primarily derived from transporting freight. Changes in freight volumes generally contribute to corresponding changes in freight revenues and certain variable expenses, such as fuel, equipment rents and crew costs. Non-freight revenues is generated from leasing of certain assets, switching fees, contracts with passenger service operators, and logistical management services.

For the three months ended March 31	**2018**	2017	Total Change	% Change	FX Adjusted % Change[(2)]
Freight revenues (in millions)[(1)]	**$1,625**	$1,563	$ 62	4	6
Non-freight revenues (in millions)	**37**	40	(3)	(8)	(8)
Total revenues (in millions)	**$1,662**	$1,603	$ 59	4	6
Carloads (in thousands)[(3)]	**649.1**	625.2	23.9	4	N/A
Revenue ton-miles (in millions)	**36,355**	34,212	2,143	6	N/A
Freight revenue per carload (in dollars)	**$2,503**	$2,499	$ 4	—	3
Freight revenue per revenue ton-mile (in cents)	**4.47**	4.57	(0.10)	(2)	—

(1) Freight revenues include fuel surcharge revenues of $101 million in 2018, and $53 million in 2017. 2018 and 2017 fuel surcharge revenues include carbon taxes, levies, and obligations under cap-and-trade programs recovered.

(2) FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore is unlikely to be comparable to similar measures presented by other companies. FX adjusted variance is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(3) Certain figures have been revised to conform with current presentation.

- **Freight revenues** were $1,625 million in the first quarter of 2018, an increase of $62 million, or 4%, from $1,563 million in the same period of 2017. This increase was primarily due to higher volumes, as measured by RTMs, of Intermodal, Potash, crude, and frac sand and the favourable impact of higher fuel surcharge revenue as a result of higher fuel prices of $42 million, partially offset by lower volumes of Grain and the unfavourable impact of the change in FX of $37 million.

- **RTMs** are defined as the movement of one revenue-producing ton of freight over a distance of one mile. RTMs measure the relative weight and distance of rail freight moved by the Company. RTMs for the first quarter of 2018 were 36,355 million, an increase of 6% compared with 34,212 million in the same period of 2017. This increase was primarily due to increases in Intermodal, Potash, crude, and frac sand, partially offset by decreases in Grain.

- **Non-freight revenues** were $37 million in the first quarter of 2018, a decrease of $3 million, or 8%, from $40 million in the same period of 2017. This decrease was primarily due to lower passenger revenues following the expiration of a passenger service contract in 2017.

Fuel Cost Adjustment Program

Freight revenues include fuel surcharge revenues associated with CP's fuel cost adjustment program, which is designed to respond to fluctuations in fuel prices and help reduce exposure to changing fuel prices. The surcharge is applied to shippers through price indices, tariffs and by contract, within agreed-upon guidelines. This program includes recoveries of carbon taxes, levies, and obligations under cap-and-trade programs. Freight revenues include fuel surcharge revenues of $101 million in the first quarter of 2018, an increase of $48 million, or 91%, from $53 million in the same period in 2017. This increase was primarily due to higher fuel prices, which represented $42 million of the change.

Lines of Business

Grain

For the three months ended March 31	**2018**	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$357**	$393	$ (36)	(9)	(7)
Carloads (in thousands)	**97.7**	106.6	(8.9)	(8)	N/A

Revenue ton-miles (in millions)	**8,729**	9,383	(654)	(7)	N/A
Freight revenue per carload (in dollars)	**$3,650**	$3,688	$ (38)	(1)	1
Freight revenue per revenue ton-mile (in cents)	**4.09**	4.19	(0.10)	(2)	—

Grain revenue was $357 million in the first quarter of 2018, a decrease of $36 million, or 9%, from $393 million in the same period of 2017. The decrease in revenue was primarily due to lower shipments of U.S. wheat primarily to the U.S. Pacific North West, lower shipments of Canadian grain to Vancouver due to harsher winter operating conditions, and the unfavourable impact of the change in FX. This decrease was partially offset by higher fuel surcharge revenue as a result of higher fuel prices. Carloads decreased greater than RTMs due to moving proportionately less U.S. grain which has a shorter length of haul versus Canadian grain.

Coal

For the three months ended March 31	**2018**	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$151**	$148	$ 3	2	3
Carloads (in thousands)	**72.8**	70.4	2.4	3	N/A
Revenue ton-miles (in millions)	**5,218**	5,123	95	2	N/A
Freight revenue per carload (in dollars)	**$2,079**	$2,096	$ (17)	(1)	—
Freight revenue per revenue ton-mile (in cents)	**2.90**	2.88	0.02	1	1

Coal revenue was $151 million in the first quarter of 2018, an increase of $3 million, or 2%, from $148 million in the same period of 2017. This increase was primarily due to higher fuel surcharge revenues as a result of higher fuel prices, and higher volumes of Canadian export coal and U.S. coal, partially offset by the unfavourable impact of the change in FX. Freight revenue per ton-mile increased due to higher freight rates and increased shorter haul U.S. coal volumes.

Potash

For the three months ended March 31	**2018**	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$112**	$98	$ 14	14	18
Carloads (in thousands)	**37.3**	31.4	5.9	19	N/A
Revenue ton-miles (in millions)	**4,381**	3,677	704	19	N/A
Freight revenue per carload (in dollars)	**$3,010**	$3,130	$ (120)	(4)	(1)
Freight revenue per revenue ton-mile (in cents)	**2.56**	2.67	(0.11)	(4)	(2)

Potash revenue was $112 million in the first quarter of 2018, an increase of $14 million, or 14%, from $98 million in the same period of 2017. This increase was primarily due to higher export potash volumes and higher fuel surcharge revenue as a result of higher fuel prices, partially offset by the unfavourable impact of the change in FX. The decrease in freight revenue per revenue ton-mile was due to moving proportionately more export potash versus domestic potash, which has a longer length of haul.

Fertilizers and Sulphur

For the three months ended March 31	**2018**	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$61**	$59	$ 2	3	5
Carloads (in thousands)	**14.9**	14.1	0.8	6	N/A
Revenue ton-miles (in millions)	**1,061**	962	99	10	N/A
Freight revenue per carload (in dollars)	**$4,074**	$4,217	$ (143)	(3)	(1)
Freight revenue per revenue ton-mile (in cents)	**5.74**	6.17	(0.43)	(7)	(4)

Fertilizers and sulphur revenue was $61 million in the first quarter of 2018, an increase of $2 million, or 3%, from $59 million in the same period of 2017. This increase was primarily due to higher fertilizer and sulphur volumes, and higher fuel surcharge revenue as a result of higher fuel prices, partially offset by the unfavourable impact of the change in FX. Freight revenue per revenue ton-mile decreased due to increased volumes of longer haul cross border traffic, which was also responsible for the greater increase in RTMs compared to carloads.

31

Forest Products

For the three months ended March 31	**2018**	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$66**	$67	$ (1)	(1)	2
Carloads (in thousands)	**16.7**	16.3	0.4	2	N/A
Revenue ton-miles (in millions)	**1,122**	1,102	20	2	N/A
Freight revenue per carload (in dollars)	**$3,937**	$4,128	$ (191)	(5)	(1)
Freight revenue per revenue ton-mile (in cents)	**5.84**	6.11	(0.27)	(4)	(1)

Forest products revenue was $66 million in the first quarter of 2018, a decrease of $1 million, or 1%, from $67 million in the same period of 2017. This decrease was due to the unfavourable impact of the change in FX and a decrease in freight revenue per revenue ton-mile, partially offset by higher fuel surcharge revenue as a result of higher fuel prices and higher volumes. Freight revenue per revenue ton-mile decreased due to increased volumes of longer haul export wood pulp from Eastern Canada to Vancouver.

Energy, Chemicals and Plastics

For the three months ended March 31	**2018**	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$257**	$227	$ 30	13	17
Carloads (in thousands)	**74.2**	66.6	7.6	11	N/A
Revenue ton-miles (in millions)	**6,157**	5,340	817	15	N/A
Freight revenue per carload (in dollars)	**$3,468**	$3,412	$ 56	2	5
Freight revenue per revenue ton-mile (in cents)	**4.18**	4.25	(0.07)	(2)	1

Energy, chemicals and plastics revenue was $257 million in the first quarter of 2018, an increase of $30 million, or 13%, from $227 million in the same period of 2017. This increase was primarily due to higher volumes of crude and liquefied petroleum gas ("L.P.G."), and higher fuel surcharge revenue as a result of higher fuel prices, partly offset by the unfavourable impact of the change in FX. The decrease in freight revenue per revenue ton-mile was primarily due to moving proportionately more crude, which has a longer length of haul. This was also responsible for a greater increase in RTMs compared to carloads.

Metals, Minerals and Consumer Products

For the three months ended March 31	**2018**	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$183**	$170	$ 13	8	12
Carloads (in thousands)	**58.6**	59.5	(0.9)	(2)	N/A
Revenue ton-miles (in millions)	**2,924**	2,560	364	14	N/A
Freight revenue per carload (in dollars)	**$3,126**	$2,851	$ 275	10	14
Freight revenue per revenue ton-mile (in cents)	**6.27**	6.63	(0.36)	(5)	(2)

Metals, minerals and consumer products revenue was $183 million in the first quarter of 2018, an increase of $13 million, or 8%, from $170 million in the same period of 2017. This increase was primarily due to higher frac sand volumes and higher fuel surcharge revenue as a result of higher fuel prices, partially offset by the unfavourable impact of the change in FX. The decrease in freight revenue per revenue ton-mile was primarily due to moving proportionately more frac sand. Carloads decreased due to a decrease in volumes of short haul copper ore.

Automotive

For the three months ended March 31	**2018**	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$71**	$76	$ (5)	(7)	(3)
Carloads (in thousands)	**25.5**	27.1	(1.6)	(6)	N/A

Revenue ton-miles (in millions)	**305**	340	(35)	(10)	N/A
Freight revenue per carload (in dollars)	**$2,792**	$2,792	$ —	—	4
Freight revenue per revenue ton-mile (in cents)	**23.32**	22.29	1.03	5	9

32

Automotive revenue was $71 million in the first quarter of 2018, a decrease of $5 million, or 7%, from $76 million in the same period of 2017. This decrease was primarily due to lower volumes and the unfavourable impact of the change in FX, partially offset by higher fuel surcharge revenue as a result of higher fuel prices, and a higher freight revenue per revenue ton-mile. The increase in freight revenue per revenue ton-mile was primarily due to higher freight rates and proportionally more trucks and sport utility vehicles ("SUV") shipped. RTMs decreased more than carloads as a result of lower tons per carload driven by moving more trucks and SUVs and fewer automobiles.

Intermodal

For the three months ended March 31	2018	2017	Total Change	% Change	FX Adjusted % Change
Freight revenues (in millions)	**$367**	$325	$ 42	13	14
Carloads (in thousands)	**251.4**	233.2	18.2	8	N/A
Revenue ton-miles (in millions)	**6,458**	5,725	733	13	N/A
Freight revenue per carload (in dollars)	**$1,458**	$1,391	$ 67	5	6
Freight revenue per revenue ton-mile (in cents)	**5.68**	5.66	0.02	—	1

Intermodal revenue was $367 million in the first quarter of 2018, an increase of $42 million, or 13%, from $325 million in the same period of 2017. This increase was primarily due to higher wholesale and temperature controlled domestic volumes, and higher international volumes through the Port of Vancouver and Detroit; as well as higher fuel surcharge revenue as a result of higher fuel prices. This increase was partially offset by the unfavourable impact of the change in FX. RTMs increased more than carloads due to moving proportionately more wholesale domestic intermodal volumes which is also driving RTMs to increase more than carloads.

Operating Expenses

			2018 vs. 2017		
For the three months ended March 31 (in millions)	2018	2017	Total Change	% Change	FX Adjusted % Change[2]
Compensation and benefits[1]	**$374**	$300	$74	25	27
Fuel	**215**	170	45	26	31
Materials	**55**	49	6	12	15
Equipment rents	**33**	36	(3)	(8)	(6)
Depreciation and amortization	**170**	166	4	2	4
Purchased services and other	**275**	278	(3)	(1)	1
Total operating expenses[1]	**$1,122**	$999	$123	12	15

[1] 2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.
[2] FX Adjusted % Change does not have any standardized meaning prescribed by GAAP and, therefore is unlikely to be comparable to similar measures presented by other companies. FX adjusted variance is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Operating expenses were $1,122 million in the first quarter of 2018, an increase of $123 million, or 12%, from $999 million in the same period of 2017. This increase was primarily due to:

- management transition recovery of $51 million associated with Mr. E. Hunter Harrison's retirement as CEO of CP in 2017;
- the unfavourable impact of increases in fuel price of $40 million;
- higher volume variable expenses;
- harsher winter operating conditions; and
- cost inflation consisting primarily of wage and benefit inflation of approximately 3%.

This increase was partially offset by the favourable impact of the change in FX of $21 million and efficiencies generated from improved operating performance and asset utilization.

Compensation and Benefits

Compensation and benefits expense includes employee wages, salaries, fringe benefits and stock-based compensation. Compensation and benefits expense was $374 million in the first quarter of 2018, an increase of $74 million, or 25%, from $300 million in the same period of 2017. This increase was primarily due to:

- management transition recovery of $51 million associated with Mr. E. Hunter Harrison's retirement as CEO of CP in 2017;
- wage and benefit inflation of approximately 3%;
- harsher winter operating conditions;
- higher volume variable expenses as a result of an increase in workload as measured by GTMs;
- higher pension current service cost; and
- higher incentive compensation.

This increase was partially offset by the benefit of operational efficiencies and the favourable impact of the change in FX.

Fuel

Fuel expense consists mainly of fuel used by locomotives and includes provincial, state and federal fuel taxes. Fuel expense was $215 million in the first quarter of 2018, an increase of $45 million, or 26%, from $170 million in the same period of 2017. This increase was primarily due to the unfavourable impact of $40 million from higher fuel prices and an increase in workload, as measured by GTMs. This increase was partially offset by the favourable impact of the change in FX of $6 million and improvements in fuel efficiency of approximately 3% primarily due to increased train capacity utilization as a result of volume growth.

Materials

Materials expense includes the cost of material used for track, locomotive, freight car and building maintenance and software sustainment. Materials expense was $55 million in the first quarter of 2018, an increase of $6 million, or 12%, from $49 million in the same period of 2017. This increase was primarily due to higher wheel expenses, partially driven by harsher winter operating conditions, and non-locomotive fuel costs, partially offset by higher material recoveries on other railroads' car repairs.

Equipment Rents

Equipment rents expense includes the cost associated with using other railways' freight cars, intermodal equipment, and locomotives, net of rental income received from other railways for the use of CP's equipment. Equipment rents expense was $33 million in the first quarter of 2018, a decrease of $3 million, or 8%, from $36 million in the same period of 2017. The decrease was primarily due to the purchase or return of leased freight cars reducing rental expense. This decrease was partially offset by lower receipts from other railroads for use of CP's equipment.

Depreciation and Amortization

Depreciation and amortization expense represents the charge associated with the use of track and roadway, buildings, rolling stock, information systems and other depreciable assets. Depreciation and amortization expense was $170 million in the first quarter of 2018, an increase of $4 million, or 2%, from $166 million in the same period of 2017. This increase was primarily due to a higher depreciable asset base partially offset by the favourable impact of the change in FX of $2 million.

Purchased Services and Other

For the three months ended March 31 (in millions)	**2018**	2017	2018 vs. 2017 Total Change	% Change
Support and facilities	**$66**	$67	$(1)	(1)
Track and operations	**72**	66	6	9
Intermodal	**53**	47	6	13
Equipment	**34**	41	(7)	(17)
Casualty	**17**	20	(3)	(15)
Property taxes	**34**	32	2	6
Other	**1**	7	(6)	(86)
Land sales	**(2)**	(2)	—	—

Total Purchased services and other	**$ 275**	$ 278	$ (3)	(1)

Purchased services and other expense encompasses a wide range of third-party costs, including expenses for joint facilities, personal injuries and damage, environmental remediation, property and other taxes, contractor and consulting fees, insurance, and gains on land sales. Purchased services and other expense was $275 million in the first quarter of 2018, a decrease of $3 million, or 1%, from $278 million in the same period of 2017. This decrease was primarily due to:

- the favourable impact of the change in FX of $6 million;
- lower engine overhaul expenses due to the capital nature of overhaul activities in 2018, reported in Equipment; and
- charges related to assets held for sale in 2017, reported in Other.

This decrease was partially offset by weather related impacts including higher snow removal, reported in Track and operations and Intermodal, and higher intermodal expenses related to pickup and delivery, reported in Intermodal.

Other Income Statement Items

Other Income and Charges

Other income and charges consists of gains and losses from the change in FX on long-term debt and working capital, various costs related to financing activities, shareholder costs, equity income and other non-operating expenditures. Other income and charges was an expense of $51 million in the first quarter of 2018, compared to a gain of $28 million in the same period of 2017, a change of $79 million, or 282%. This change was primarily due to the unfavourable impact of FX translation of $49 million on U.S. dollar-denominated debt during the first quarter of 2018, compared to the favourable impact of FX translation of $28 million in the same period of 2017, discussed further in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Other Components of Net Periodic Benefit

Other components of net periodic benefit was a recovery of $96 million in the first quarter of 2018, compared to a recovery of $67 million in the same period of 2017, a change of $29 million or 43%. This change was primarily due to an increase in the expected return on fund assets and a decrease in the recognized net actuarial loss.

Net Interest Expense

Net interest expense includes interest on long-term debt and capital leases. Net interest expense was $115 million in the first quarter of 2018, a decrease of $5 million, or 4%, from $120 million in the same period of 2017. This decrease was primarily due to the favourable impact of the change in FX of $4 million.

Income Tax Expense

Income tax expense was $122 million in the first quarter of 2018, a decrease of $26 million, or 18%, from $148 million in the same period of 2017. This decrease was due to lower taxable earnings.

The effective tax rate in the first quarter of 2018, including discrete items was 25.92%, compared with 25.60% in the same period of 2017. The effective tax rate in the first quarter of 2018, excluding discrete items, was 24.75% compared to 26.50% in 2017. This decrease is primarily due to the reduction in the U.S. federal income tax rate under the Tax Cuts and Jobs Act enacted in the fourth quarter of 2017, effective January 1, 2018.

The Company expects an annualized effective tax rate in 2018 of approximately 24.5% to 25%. The Company's 2018 outlook for its annualized effective income tax rate is based on certain assumptions about events and developments that may or may not materialize or that may be offset entirely or partially by new events and developments. This is discussed further in Item 1A. Risk Factors of CP's 2017 Annual Report on Form 10-K.

Liquidity and Capital Resources

The Company believes adequate amounts of Cash and cash equivalents are available in the normal course of business to provide for ongoing operations, including the obligations identified in the tables in Contractual Commitments of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. The Company is not aware of any trends or expected fluctuations in the Company's liquidity that would create any deficiencies. The Company's primary sources of liquidity include its Cash and cash equivalents, its bilateral letter of credit facilities, and its revolving credit facility.

As at March 31, 2018, the Company had $125 million of Cash and cash equivalents, U.S. $2.0 billion available under its revolving credit facility and up to $299 million available under its letters of credit (December 31, 2017 - $338 million of Cash and cash equivalents, U.S. $2.0 billion available under its revolving credit facility and up to $281 million available under its letters of credit).

As at March 31, 2018, the Company's U.S. $2.0 billion revolving credit facility, which includes a U.S. $1.0 billion five-year portion and U.S. $1.0 billion one-year plus one-year term-out portion, was undrawn (December 31, 2017 - undrawn). The Company did not draw from its revolving credit facility during the three months ended March 31, 2018. The revolving credit facility agreement requires the Company not to exceed a maximum debt to earnings before interest, tax, depreciation, and amortization ratio. As at March 31, 2018, the Company was in compliance with the threshold stipulated in this financial covenant.

The Company has a commercial paper program that enables it to issue commercial paper up to a maximum aggregate principal amount of U.S. $1.0 billion in the form of unsecured promissory notes. The commercial paper is backed by the U.S. $1.0 billion one-year plus one-year term-out portion of the revolving credit facility. As at March 31, 2018, total commercial paper borrowings were U.S. $nil (December 31, 2017 - $nil).

As at March 31, 2018, under its bilateral letters of credit facility, the Company had letters of credit drawn of $301 million from a total available amount of $600 million. This compares to letters of credit drawn of $319 million from a total available amount of $600 million as at December 31, 2017. Under the bilateral letters of credit facility, the Company has the option to post collateral in the form of Cash or cash equivalents, equal at least to the face value of the letters of credit issued. As at March 31, 2018, the Company had no collateral posted on its bilateral letters of credit facility (December 31, 2017 - $150 million).

The following discussion of operating, investing and financing activities describes the Company's indicators of liquidity and capital resources.

Operating Activities

Cash provided by operating activities was $397 million in the first quarter of 2018, an increase of $86 million compared to $311 million in the same period of 2017. This increase was primarily due to a favourable change in working capital mainly as a result of lower taxes paid in the first quarter of 2018.

Investing Activities

Cash used in investing activities was $238 million in the first quarter of 2018, an increase of $16 million compared to $222 million in the same period of 2017. This increase was primarily due to higher capital additions during 2018 compared to the same period in 2017.

Free Cash

CP generated positive Free cash of $164 million in the first quarter of 2018, an increase of $77 million from $87 million in the same period of 2017. This increase was primarily due to an increase in cash provided by operating activities compared to the same period of 2017.

Free cash is affected by seasonal fluctuations and by other factors including the size of the Company's additions to properties. Free cash is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Financing Activities

Cash used in financing activities was $377 million in the first quarter of 2018, an increase of $327 million compared to $50 million in the same period of 2017. This increase was primarily due to payments to buy back shares under the Company's share repurchase program in 2018.

Credit Measures

Credit ratings provide information relating to the Company's financing costs, liquidity and operations and affect the Company's ability to obtain short-term and long-term financing and/or the cost of such financing.

A mid-investment grade credit rating is an important measure in assessing the Company's ability to maintain access to public financing and to minimize the cost of capital. It also affects the ability of the Company to engage in certain collateralized business activities on a cost-effective basis.

Credit ratings and outlooks are based on the rating agencies' methodologies and can change from time to time to reflect their views of CP. Their views are affected by numerous factors including, but not limited to, the Company's financial position and liquidity along with external factors beyond the Company's control.

As at March 31, 2018, CP's credit ratings from Standard & Poor's Rating Services ("Standard & Poor's") and Moody's Investor Service ("Moody's") remain unchanged from December 31, 2017.

Credit ratings as at March 31, 2018[(1)]

Long-term debt		Outlook
Standard & Poor's		
Long-term corporate credit	**BBB+**	stable
Senior secured debt	**A**	stable
Senior unsecured debt	**BBB+**	stable
Moody's		
Senior unsecured debt	**Baa1**	stable
$1 billion Commercial paper program		
Standard & Poor's	**A-2**	N/A
Moody's	**P-2**	N/A

(1) Credit ratings are not recommendations to purchase, hold or sell securities and do not address the market price or suitability of a specific security for a particular investor. Credit ratings are based on the rating agencies' methodologies and may be subject to revision or withdrawal at any time by the rating agencies.

The Adjusted net debt to Adjusted earnings before interest, tax, depreciation and amortization ("EBITDA") ratio for the twelve months ended March 31, 2018 and March 31, 2017 was 2.7 and 2.9, respectively. This decrease was primarily due to lower Adjusted net debt as a result of the favourable impact from the change in FX on U.S. dollar-denominated debt, as well as an increase in Adjusted EBITDA for the twelve months ended March 31, 2018. Adjusted net debt to Adjusted EBITDA ratio is defined and reconciled in Non-GAAP Measures of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. Over the long term, CP targets an Adjusted net debt to Adjusted EBITDA ratio of 2.0 to 2.5.

Share Capital

At April 16, 2018, the latest practicable date, there were 143,074,798 Common Shares and no preferred shares issued and outstanding, which consists of 14,515 holders of record of the Company's Common Shares. In addition, CP has a Management Stock Option Incentive Plan ("MSOIP"), under which key officers and employees are granted options to purchase CP Common Shares. Each option granted can be exercised for one Common Share. At April 16, 2018, 1.6 million options were outstanding under the Company's MSOIP and stand-alone option agreements entered into with Mr. Keith Creel. There are 1.4 million options available to be issued by the Company's MSOIP in the future.

CP has a Director's Stock Option Plan ("DSOP"), under which directors are granted options to purchase CP Common Shares. There are no outstanding options under the DSOP, which has 0.3 million options available to be issued in the future.

Non-GAAP Measures

The Company presents non-GAAP measures and cash flow information to provide a basis for evaluating underlying earnings and liquidity trends in the Company's business that can be compared with the results of operations in prior periods. In addition, these non-GAAP measures facilitate a multi-period assessment of long-term profitability allowing management and other external users of the Company's consolidated financial information to compare profitability on a long-term basis, including assessing future profitability, with that of the Company's peers.

These non-GAAP measures have no standardized meaning and are not defined by GAAP and, therefore, may not be comparable to similar measures presented by other companies. The presentation of these non-GAAP measures is not intended to be considered in isolation from, as a substitute for, or as superior to, the financial information presented in accordance with GAAP.

Adjusted Performance Measures

The Company uses Adjusted income, Adjusted diluted earnings per share, Adjusted operating income and Adjusted operating ratio to evaluate the Company's operating performance and for planning and forecasting future business operations and future profitability. These non-GAAP measures are presented in Financial Highlights and discussed further in other sections of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. These non-GAAP measures provide meaningful supplemental information regarding operating results because they exclude certain significant items that are not considered indicative of future financial trends either by nature or amount. As a result, these items are excluded for management assessment of operational performance, allocation of resources and preparation of annual budgets. These significant items may include, but are not limited to, restructuring and asset impairment charges, individually significant gains and losses from sales of assets, and certain items outside the control of management. These items may not be non-recurring. However, excluding these significant items from GAAP results allows for a consistent understanding of the Company's consolidated financial performance when performing a multi-period assessment including assessing the likelihood of future results. Accordingly, these non-GAAP financial measures may provide insight to investors and other external users of the Company's consolidated financial information.

In the first quarter of 2018, there was one significant item included in Net income as follows:

- a net non-cash loss of $49 million ($42 million after deferred tax) due to FX translation of the Company's U.S. dollar-denominated debt that unfavourably impacted Diluted EPS by 29 cents.

In 2017, there were five significant items included in Net income as follows:

- in the second quarter, a charge on hedge roll and de-designation of $13 million ($10 million after deferred tax) that unfavourably impacted Diluted EPS by 7 cents;
- in the second quarter, an insurance recovery of a legal settlement of $10 million ($7 million after current tax) that favourably impacted Diluted EPS by 5 cents;
- in the first quarter, a management transition recovery of $51 million related to the retirement of Mr. E. Hunter Harrison as CEO of CP ($39 million after deferred tax) that favourably impacted Diluted EPS by 27 cents;
- during the course of the year, a net deferred tax recovery of $541 million as a result of changes in income tax rates as follows:
- in the fourth quarter, a deferred tax recovery of $527 million, primarily due to the U.S. tax reform, that favourably impacted Diluted EPS by $3.63;
- in the third quarter, a deferred tax expense of $3 million as a result of the change in the Illinois state corporate income tax rate change that unfavourably impacted Diluted EPS by 2 cents;
- in the second quarter, a deferred tax recovery of $17 million as a result of the change in the Saskatchewan provincial corporate income tax rate that favourably impacted Diluted EPS by 12 cents; and
- during the course of the year, a net non-cash gain of $186 million ($162 million after deferred tax) due to FX translation of the Company's U.S. dollar-denominated debt as follows:
- in the fourth quarter, a $14 million loss ($12 million after deferred tax) that unfavourably impacted Diluted EPS by 8 cents;
- in the third quarter, a $105 million gain ($91 million after deferred tax) that favourably impacted Diluted EPS by 62 cents;
- in the second quarter, a $67 million gain ($59 million after deferred tax) that favourably impacted Diluted EPS by 40 cents; and
- in the first quarter, a $28 million gain ($24 million after deferred tax) that favourably impacted Diluted EPS by 16 cents.

In the nine months ended December 31, 2016, there were two significant items included in Net income as follows:

- in the third quarter, a $25 million expense ($18 million after current tax) related to a legal settlement that unfavourably impacted Diluted EPS by 12 cents; and
- during the first nine months, a net non-cash loss of $102 million ($88 million after deferred tax) due to FX translation of the Company's U.S. dollar-denominated debt as follows:
- in the fourth quarter, a $74 million loss ($64 million after deferred tax) that unfavourably impacted Diluted EPS by 43 cents;
- in the third quarter, a $46 million loss ($40 million after deferred tax) that unfavourably impacted Diluted EPS by 27 cents; and
- in the second quarter, an $18 million gain ($16 million after deferred tax) that favourably impacted Diluted EPS by 10 cents.

Reconciliation of GAAP Performance Measures to Non-GAAP Performance Measures

The following tables reconcile the most directly comparable measures presented in accordance with GAAP to the non-GAAP measures presented in Financial Highlights and discussed further in other sections of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for the three months ended March 31, 2018 and 2017:

Adjusted income is calculated as Net income reported on a GAAP basis less significant items.

	For the three months ended March 31	
(in millions)	**2018**	2017
Net income as reported	**$348**	$431
Less significant items (pretax):		
Management transition recovery	**—**	51
Impact of FX translation on U.S. dollar-denominated debt	**(49)**	28
Add:		
Tax effect of adjustments[(1)]	**(7)**	16
Adjusted income	**$390**	$368

(1) The tax effect of adjustments was calculated as the pretax effect of the adjustments multiplied by the applicable tax rate for the above items of 13.43% and 19.88% for the three months ended March 31, 2018 and 2017, respectively. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

Adjusted diluted earnings per share is calculated using Adjusted income, as defined above, divided by the weighted-average diluted shares outstanding during the period as determined in accordance with GAAP.

	For the three months ended March 31	
	2018	2017
Diluted earnings per share as reported	**$2.41**	$2.93
Less significant items (pretax):		
Management transition recovery	**—**	0.35
Impact of FX translation on U.S. dollar-denominated debt	**(0.34)**	0.19
Add:		
Tax effect of adjustments[1]	**(0.05)**	0.11
Adjusted diluted earnings per share	**$2.70**	$2.50

(1) The tax effect of adjustments was calculated as the pretax effect of the adjustments multiplied by the applicable tax rate for the above items of 13.43% and 19.88% for the three months ended March 31, 2018 and 2017, respectively. The applicable tax rates reflect the taxable jurisdictions and nature, being on account of capital or income, of the significant items.

Adjusted operating income is calculated as Operating income reported on a GAAP basis less significant items.

	For the three months ended March 31	
(in millions)	**2018**	2017
Operating income as reported[1]	**$540**	$604
Less significant item:		
Management transition recovery	**—**	51
Adjusted operating income[1]	**$540**	$553

(1)2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.

Adjusted operating ratio excludes those significant items that are reported within Operating income.

	For the three months ended March 31	
	2018	2017
Operating ratio as reported[1]	**67.5%**	62.4 %
Less significant item:		
Management transition recovery	**—**	(3.2)
Adjusted operating ratio[1]	**67.5%**	65.6 %

(1)2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.

ROIC and Adjusted ROIC

ROIC is calculated as Operating income less Other income and charges, tax effected at the Company's annualized effective tax rate, on a rolling twelve-month basis, divided by the sum of total Shareholders' equity, Long-term debt, Long-term debt maturing within one year and Short-term borrowing, as presented in the Company's Consolidated Financial Statements, averaged between the beginning and ending balance over a rolling twelve-month period. Adjusted ROIC excludes significant items reported in Operating income and Other income and charges in the Company's Consolidated Financial Statements, as these significant items are not considered indicative of future financial trends either by nature or amount. Total Shareholders' equity, Long-term debt, Long-term debt maturing within one year and Short-term borrowing is similarly adjusted for the impact of these significant items, net of tax, on closing balances as part of this average. ROIC and Adjusted ROIC are all-encompassing performance measures that measure how productively the Company uses its long-term capital investments, representing critical indicators of good operating and investment decisions made by management and are important performance criteria in determining certain elements of the Company's long-term incentive plan. ROIC and Adjusted ROIC are presented in Financial Highlights and discussed further in Results of Operations of this Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

Calculation of ROIC and Adjusted ROIC

	For the twelve months ended March 31	
(in millions, except for percentages)	**2018**	2017
Operating income as reported[(1)]	**$2,455**	$2,405
Less:		
Other income and charges	**(99)**	108
Other components of net periodic benefit recovery[(1)]	**(303)**	(191)
Tax[(2)]	**86**	654
	$2,771	$1,834
Average of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	**14,222**	13,698
ROIC	**19.5 %**	13.4 %

(1) 2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.

(2) Tax was calculated at the annualized effective tax rate of 2.99% and 26.27% for each of the above items for the twelve months ended March 31, 2018 and 2017, respectively.

	For the twelve months ended March 31	
(in millions, except for percentages)	**2018**	2017
Operating income as reported[(1)]	**$2,455**	$2,405
Less significant item:		
Management transition recovery	**—**	51
Adjusted operating income	**2,455**	2,354
Less:		
Other income and charges	**(99)**	108
Other components of net periodic benefit recovery[(1)]	**(303)**	(191)
Add significant items (pretax):		
Legal settlement charge	**—**	25
Insurance recovery of legal settlement	**(10)**	—
Charge on hedge roll and de-designation	**13**	—
Impact of FX translation on U.S. dollar-denominated debt	**(109)**	74
Less:		
Tax[(2)]	**716**	657
	$2,035	$1,879
Average for the twelve months of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	**14,222**	13,698
Add:		
Impact of periodic significant items net of tax on the above average	**(269)**	(11)
Adjusted average for the twelve months of total shareholders' equity, long-term debt, long-term debt maturing within one year and short-term borrowing	**13,953**	13,687
Adjusted ROIC[(3)]	**14.6 %**	13.7 %

(1) 2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.

(2) Tax was calculated at the adjusted annualized effective tax rate of 26.02% and 25.91% for each of the above items for the twelve months ended March 31, 2018 and 2017, respectively.

(3) The definition of Adjusted ROIC has been revised to exclude the impact of periodic significant items net of tax on closing total Shareholders' equity, Long-term debt, Long-term debt maturing within one year and Short-term borrowing as part of the average calculation. The change did not have a significant impact on the 2017 comparative period.

Free Cash

Free cash is calculated as Cash provided by operating activities, less Cash used in investing activities, adjusted for changes in cash and cash equivalents balances resulting from FX fluctuations. Free cash is a measure that management considers to be an indicator of liquidity. Free cash is useful to investors and other external users of the consolidated financial statements as it assists with the evaluation of the Company's ability to generate cash from its operations without incurring additional external financing. Positive Free cash indicates the amount of cash available for reinvestment in the business, or cash that can be returned to investors through dividends, stock repurchase programs, debt retirements or a combination of these. Conversely, negative Free cash indicates the amount of cash that must be raised from investors through new debt or equity issues, reduction in available cash balances or a combination of these. Free cash should be considered in addition to, rather than as a substitute for, Cash provided by operating activities. Free cash is presented in Financial Highlights and discussed further in Liquidity and Capital Resources of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Reconciliation of Cash Provided by Operating Activities to Free Cash

(in millions)	For the three months ended March 31 2018	2017
Cash provided by operating activities	**$397**	$311
Cash used in investing activities	**(238)**	(222)
Effect of foreign currency fluctuations on U.S. dollar-denominated cash and cash equivalents	**5**	(2)
Free cash	**$164**	$87

FX Adjusted Variance

FX adjusted variance allows certain financial results to be viewed without the impact of fluctuations in foreign currency exchange rates, thereby facilitating period-to-period comparisons in the analysis of trends in business performance. Financial result variances at constant currency are obtained by translating the comparable period of the prior year results denominated in U.S. dollars at the foreign exchange rates of the current period. FX adjusted variances are discussed in Operating Revenues and Operating Expenses of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

(in millions)	**For the three months ended March 31** Reported 2018	Reported 2017	Variance due to FX	FX Adjusted 2017	FX Adjusted % Change
Freight revenues	1,625	1,563	(37)	$ 1,526	6
Non-freight revenues	37	40	—	40	(8)
Total revenues	**1,662**	**1,603**	**(37)**	1,566	6
Compensation and benefits[(1)]	374	300	(5)	295	27
Fuel	215	170	(6)	164	31
Materials	55	49	(1)	48	15
Equipment rents	33	36	(1)	35	(6)
Depreciation and amortization	170	166	(2)	164	4
Purchased services and other	275	278	(6)	272	1
Total operating expenses[(1)]	**1,122**	**999**	**(21)**	978	15
Operating income[(1)]	**540**	**604**	**(16)**	$ 588	(8)

(1) 2017 comparative period figure has been restated for the retrospective adoption of ASU 2017-07, discussed further in Item 1. Financial Statements, Note 2 Accounting changes.

Reconciliation of Net Income to EBIT, Adjusted EBIT and Adjusted EBITDA

EBIT is calculated as Net income before Net interest expense and Income tax expense. Adjusted EBIT excludes significant items reported in Operating income and Other income and charges. Adjusted EBITDA is calculated as Adjusted EBIT plus Depreciation and amortization, net periodic pension and other benefit cost other than current service costs, and operating lease expense.

(in millions)	For the twelve months ended March 31 2018	2017
Net income as reported	**$2,322**	$1,490
Add:		
Net interest expense	**468**	467
Income tax expense	**67**	531
EBIT	**2,857**	2,488
Less significant items (pretax):		
Legal settlement charge	**—**	(25)
Insurance recovery of legal settlement	**10**	—
Charge on hedge roll and de-designation	**(13)**	—
Management transition recovery	**—**	51
Impact of FX translation on U.S. dollar-denominated debt	**109**	(74)
Adjusted EBIT	**2,751**	2,536
Less:		
Other components of net periodic benefit recovery	**303**	191
Operating lease expense	**(98)**	(106)
Depreciation and amortization	**(665)**	(644)
Adjusted EBITDA	**$3,211**	$3,095

Adjusted Net Debt to Adjusted EBITDA Ratio

Adjusted net debt is defined as Long-term debt, Long-term debt maturing within one year and Short-term borrowing as reported on the Company's Consolidated Balance Sheets adjusted for pension plans deficit, the net present value of operating leases, which is discounted by the Company's effective interest rate for each of the years presented, and Cash and cash equivalents. Adjusted net debt to Adjusted EBITDA ratio is calculated as Adjusted net debt divided by Adjusted EBITDA. The Adjusted net debt to Adjusted EBITDA ratio is a key credit measure used to assess the Company's financial capacity. The ratio provides information on the Company's ability to service its debt and other long-term obligations. Adjusted net debt to Adjusted EBITDA ratio is discussed further in Liquidity and Capital Resources of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Reconciliation of Long-term Debt to Adjusted Net Debt

(in millions)	2018	2017
Long-term debt including long-term debt maturing within one year as at March 31	**$8,357**	$8,614
Less:		
Pension plans in deficit(1)	**(278)**	(271)
Net present value of operating leases(2)	**(276)**	(330)
Cash and cash equivalents	**125**	201
Adjusted net debt as at March 31	**$8,786**	$9,014

(1) Pension plans deficit is the total funded status of the Pension plans in deficit only.

(2) Operating leases were discounted at the Company's effective interest rate for each of the periods presented.

Calculation of Adjusted Net Debt to Adjusted EBITDA Ratio

(in millions, except for ratios)	2018	2017
Adjusted net debt as at March 31	**$8,786**	$9,014
Adjusted EBITDA for the year ended March 31	**3,211**	3,095
Adjusted net debt to Adjusted EBITDA ratio	**2.7**	2.9

Off-Balance Sheet Arrangements

Guarantees

At March 31, 2018, the Company had residual value guarantees on operating lease commitments of $6 million, compared to $6 million at December 31, 2017. The maximum amount that could be payable under these and all of the Company's other guarantees cannot be reasonably estimated due to the nature of certain guarantees. All or a portion of amounts paid under certain guarantees could be recoverable from other parties or through insurance. As at March 31, 2018, the fair value of these guarantees recognized as a liability was $10 million, compared to $9 million at December 31, 2017.

Contractual Commitments

The accompanying table indicates the Company's obligations and commitments to make future payments for contracts, such as debt, capital lease and commercial arrangements, as at March 31, 2018.

Payments due by period (in millions)	**Total**	2018	2019 & 2020	2021 & 2022	2023 & beyond
Contractual commitments					
Interest on long-term debt and capital lease	**$11,438**	$304	$798	$722	$9,614
Long-term debt	**8,290**	748	538	837	6,167
Capital leases	**154**	3	10	110	31
Operating lease[1]	**346**	53	111	71	111
Supplier purchase	**1,575**	481	636	133	325
Other long-term liabilities[2]	**479**	40	101	101	237
Total contractual commitments	**$22,282**	$1,629	$2,194	$1,974	$16,485

f $1 million are not included in the minimum payments shown above. Where management believes that CP will be required to make payments under these residual value guarantees, the fair value of these guarantees as at March 31, 2018 of $5 million has been recognized as a liability.

[2] Includes expected cash payments for restructuring, environmental remediation, post-retirement benefits, workers' compensation benefits, long-term disability benefits, pension benefit payments for the Company's non-registered supplemental pension plan and certain other long-term liabilities. Projected payments for post-retirement benefits, workers' compensation benefits and long-term disability benefits include the anticipated payments for years 2018 to 2027. Pension contributions for the Company's registered pension plans are not included due to the volatility in calculating them. Pension payments are discussed further in Critical Accounting Estimates of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Certain Other Financial Commitments

In addition to the financial commitments mentioned previously in Off-Balance Sheet Arrangements and Contractual Commitments of this Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, the Company is party to certain other financial commitments discussed below.

Letters of Credit

Letters of credit are obtained mainly to provide security to third parties under the terms of various agreements, including the supplemental pension plan. CP is liable for these contractual amounts in the case of non-performance under these agreements. Letters of credit are accommodated through a revolving credit facility and the Company's bilateral letter of credit facilities.

Capital Commitments

The Company remains committed to maintaining the current high level of quality of our capital assets in pursuing sustainable growth. As part of this commitment, CP has entered into contracts with suppliers to make various capital purchases related to track programs. Payments for these commitments are due in 2018 through 2032. These expenditures are expected to be financed by cash generated from operations or by issuing new debt.

The accompanying table indicates the Company's commitments to make future payments for letters of credit and capital expenditures as at March 31, 2018.

Payments due by period (in millions)	**Total**	2018	2019 & 2020	2021 & 2022	2023 & beyond

Certain other financial commitments					
Letters of credit	**$301**	$301	$—	$ —	$ —
Capital commitments	**757**	327	190	74	166
Total certain other financial commitments	**$1,058**	$628	$190	$ 74	$ 166

41

Critical Accounting Estimates

To prepare consolidated financial statements that conform with GAAP, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reported periods. Using the most current information available, the Company reviews estimates on an ongoing basis, including those related to environmental liabilities, pensions and other benefits, property, plant and equipment, deferred income taxes, and personal injury and other claims liabilities. Additional information concerning critical accounting estimates is supplemented in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company's 2017 Annual Report on 10-K. There have not been any material changes to the Company's critical accounting estimates in the first three months of 2018.

The development, selection and disclosure of these estimates, and this MD&A, have been reviewed by the Board of Directors' Audit Committee, which is composed entirely of independent directors.

Forward-Looking Information

This MD&A and Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995 and other relevant securities legislation. These forward-looking statements include, but are not limited to, statements concerning the Company's defined benefit pension expectations for 2018 and through 2021, our expectations for 2018 which includes an effective tax rate in the range of 24.5 to 25 percent, as well as statements concerning the Company's operations, anticipated financial performance, business prospects and strategies, including statements concerning the anticipation that cash flow from operations and various sources of financing will be sufficient to meet debt repayments and obligations in the foreseeable future and concerning anticipated capital programs, statements regarding future payments including income taxes and pension contributions, and capital expenditures. Forward-looking information typically contains statements with words such as “financial expectations”, “key assumptions”, “anticipate”, “believe”, “expect”, “plan”, “will”, “outlook”, “should” or similar words suggesting future outcomes. To the extent that CP has provided guidance using non-GAAP financial measures, the Company may not be able to provide a reconciliation to a GAAP measure, due to unknown variables and uncertainty related to future results.

Readers are cautioned not to place undue reliance on forward-looking information because it is possible that CP will not achieve predictions, forecasts, projections and other forms of forward-looking information. Current economic conditions render assumptions, although reasonable when made, subject to greater uncertainty. In addition, except as required by law, CP undertakes no obligation to update publicly or otherwise revise any forward-looking information, whether as a result of new information, future events or otherwise.

By its nature, forward-looking information involves numerous assumptions, inherent risks and uncertainties, including but not limited to the following factors: changes in business strategies; general North American and global economic, credit and business conditions; risks in agricultural production such as weather conditions and insect populations; the availability and price of energy commodities; the effects of competition and pricing pressures; industry capacity; shifts in market demand; inflation; changes in laws and regulations, including regulation of rates; changes in taxes and tax rates; potential increases in maintenance and operating costs; uncertainties of investigations, proceedings or other types of claims and litigation; labour disputes; risks and liabilities arising from derailments; transportation of dangerous goods; timing of completion of capital and maintenance projects; currency and interest rate fluctuations; effects of changes in market conditions on the financial position of pension plans and investments; and various events that could disrupt operations, including severe weather, droughts, floods, avalanches and earthquakes as well as security threats and the governmental response to them, and technological changes.

There are more specific factors that could cause actual results to differ materially from those described in the forward-looking statements contained in this MD&A. These more specific factors are identified and discussed in Item 1A. Risk Factors of CP's 2017 Annual Report on Form 10-K. Other risks are detailed from time to time in reports filed by CP with securities regulators in Canada and the United States.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes to market risk during the three months ended March 31, 2018 from the information provided in Item 7A. Quantitative and Qualitative Disclosure about Market Risk of CP's 2017 Annual Report on Form 10-K. Refer to information on foreign exchange risk and share price impact on stock-based compensation discussed below:

Foreign Exchange Risk

Although CP conducts business primarily in Canada, a significant portion of its revenues, expenses, assets and liabilities including debt are denominated in U.S. dollars. The value of the Canadian dollar is affected by a number of domestic and international factors, including, without limitation, economic performance, and Canadian, U.S. and international monetary policies. Consequently, the Company's results are affected by fluctuations in the exchange rate between these currencies. On an annualized basis, a $0.01 weakening (or strengthening) of the Canadian dollar positively (or negatively) impacts Total revenues by approximately $27 million and negatively (or positively) impacts Operating expenses by approximately $14 million.

CP uses U.S. dollar-denominated debt to hedge its net investment in U.S. operations. As at March 31, 2018, the net investment in U.S. operations is less than the total U.S. denominated debt. Consequently, FX translation on the Company's undesignated U.S. dollar-denominated long-term debt causes additional impacts on earnings in Other income and charges. For further information, please refer to Item 8. Financial Statements and Supplementary Data, Note 17 Financial Instruments, in CP's 2017 Annual Report on Form 10-K.

To manage this exposure to fluctuations in exchange rates between Canadian and U.S. dollars, CP may sell or purchase U.S. dollar forwards at fixed rates in future periods. In addition, changes in the exchange rate between the Canadian dollar and other currencies (including the U.S. dollar) make the goods transported by the Company more or less competitive in the world marketplace and may in turn positively or negatively affect revenues.

Share Price Impact on Stock-Based Compensation

For every $1.00 change in share price, stock-based compensation expense has a corresponding change of approximately $0.3 million to $0.5 million based on information available at March 31, 2018. This excludes the impact of changes in share price relative to the S&P/TSX 60 Index, the S&P/TSX Capped Industrial Index, the S&P 1500 Road and Rail Index, and to Class I railways, which may trigger different performance share unit payouts. Share based compensation may also be impacted by non-market performance conditions.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of March 31, 2018, an evaluation was carried out under the supervision of and with the participation of CP's management, including its CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based on that evaluation, the CEO and CFO concluded that these disclosure controls and procedures were effective as of March 31, 2018, to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified by the SEC rules and forms and (ii) accumulated and communicated to the Company’s management, including the CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

During the first quarter of 2018, the Company has not identified any changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

For further details refer to Item 1. Financial Statements, Note 12 Contingencies.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors from the information provided in Item 1A. Risk Factors of CP's 2017 Annual Report on Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Issuer Purchase of Equity Securities

On May 10, 2017, CP announced a new normal course issuer bid ("NCIB") to repurchase, for cancellation, up to 4,384,062 of its Common Shares, which received Toronto Stock Exchange ("TSX") approval on May 10, 2017. The NCIB commenced on May 15, 2017 and will expire on May 14, 2018. During the first quarter of 2018, CP repurchased 1.4 million Common Shares in total for $318 million at a weighted average price of $221.76. The following table presents Common Shares repurchased during each month for the first quarter of 2018.

2018	Total Number of Shares Purchased[1]	Average Price Paid per Share[2]	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
January 1 to January 31	371,300	$ 221.12	371,300	2,124,662
February 1 to February 28	444,400	216.06	444,400	1,680,262
March 1 to March 31	620,000	226.22	620,000	1,060,262
Ending Balance	**1,435,700**	**$ 221.76**	**1,435,700**	**N/A**

(1) Includes shares repurchased but not yet canceled at quarter end.

(2) Includes brokerage fees.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit	Description
31.1**	CEO Rule 13a-14(a) Certifications
31.2**	CFO Rule 13a-14(a) Certifications
32.1**	CEO Section 1350 Certifications
32.2**	CFO Section 1350 Certifications
101.INS**	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document
	The following financial information from Canadian Pacific Railway Limited's Quarterly Report on Form 10-Q for the first quarter ended March 31, 2018, formatted in Extensible Business Reporting Language (XBRL) includes: (i) the Interim Consolidated Statements of Income for the first quarters ended March 31, 2018 and 2017; (ii) the Consolidated Statements of Comprehensive Income for the first quarters ended March 31, 2018 and 2017; (iii) the Consolidated Balance Sheets at March 31, 2018, and December 31, 2017; (iv) the Consolidated Statements of Cash Flows for the first quarters ended March 31, 2018 and 2017; (v) the Consolidated Statements of Changes in Shareholders' Equity for the first quarters ended March 31, 2018 and 2017; and (vi) the Notes to Consolidated Financial Statements.

**Filed with this Quarterly Report on Form 10-Q

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CANADIAN PACIFIC RAILWAY LIMITED
(Registrant)
By: /s/ NADEEM VELANI
Nadeem Velani
Executive Vice-President and Chief Financial Officer
(Principal Financial Officer)

Dated: April 18, 2018